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No. 18245

In the

United States Court of Appeals

for the Ninth Circuit

ANGUS J. DE PINTO, HJALMAR B. LANDOE FRANCIS I. SABO and EDWIN B. PEGRAM, ELMER W. DUHAME,

Appellants,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and JOHN S. GORSUCH and ALBERT J. DOIG,

Appellees.

Reply Brief of Appellants Francis I. Sabo and Edwin B. Pegram

On Appeal from the United States District Court for the District of Arizona

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

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INTRODUCTION

With the voluminous record and numerous briefs already filed in this matter, including the prior appeal in No. 17114, we shall make every effort to avoid unnecessary repetition in this closing brief. However, we do wish to emphasize once again the significant distinctions between the remaining parties.

There has been a tendency, both on the part of Appellees and of the District Court, to attribute to all of the Defendants the errors and defalcations of each of them. Where there is no factual or legal support for such grouping, the unfortunate result has been to penalize the innocent along with the guilty. Now the brief of Appellees is replete with references to alleged irresponsibility or misconduct of some of the Defendants and their Attorneys. We therefore ask the Court, in reviewing the arguments and accusations made by Appellees, to note with particular care the parties to whom they properly apply.

SUMMARY OF ARGUMENT

1. Nothing could have been done by Sabo or Pegram after October 18, 1957, which would have prevented or minimized loss to United by reason of the asserted diversion of assets (Referring to Pages 102 and 103 of Appellees' brief).

2. There is no basis in the Findings of Fact or Conclusions of Law, or in the law or the evidence, for imposition of liability upon Sabo and Pegram for breach of a fiduciary duty owed by them to United as controlling shareholders on October 18, 1957 (Referring to Pages 84 through 87 of Appellees' brief).

3. Neither Sabo nor Pegram had, or should reasonably have had, any knowledge of their election as Directors of United on October 18, 1957, or of any improprieties in the transactions which occurred on that date (Referring to Pages 103 through 107 and to Pages 87 through 102 of Appellees' brief).

4. Neither Sabo nor Pegram is liable to United as a Director of American on October 18, 1957, for:

a. Knowing participation with fiduciaries in the breach of fiduciary duties (Referring to Pages 87 through 97 of Appellees' brief); or

b. Negligence in failing to supervise the activities of the other Officers and Directors of American on that date (Referring to Pages 97 through 102 of Appellees' brief).

5. Neither DePinto nor Duhame is entitled to contribution or indemnity from Sabo or Pegram with regard to any recovery had against them in this action (Referring to Pages 37 and 38 of the brief of Appellant DePinto).

ARGUMENT

1. Nothing Could Have Been Done by Sabo or Pegram After October 18, 1957, Which Would Have Prevented or Minimized Loss to United by Reason of the Asserted Diversion of Assets (Referring to Pages 102 and 103 of Appellees' brief).

In remanding this action for further proceedings, this Court requested a further finding by the District Court with regard to what action, if any, Appellants Sabo and Pegram could have taken in November or December, 1957, "which would have prevented or minimized loss to United by the reason of the asserted diversion of assets." *(Niesz v. Gorsuch,* No. 17114; 295 F. 2d 909, 914) The response of the District Court is, quite clearly, "Nothing."

There has been no evidence whatever that any action which might have been taken by Sabo or Pegram after October 18, 1957, would have been at all effective in preventing or minimizing the loss. The District Court found, in its Supplemental Finding 24 (Tr. 1728):

> "* * * After October 18, 1957, had passed, and the loss had occurred, none of the Defendants could take action which would prevent the loss which had already occurred."

As Appellees apparently acknowledge in their brief, the relevant question now is whether Sabo and Pegram were under any duty to United *on or before October 18, 1957,* the due performance of which would have prevented or minimized the irrevocable loss which then occurred. It is conceded, of course, that the loss could have been prevented by the simple expedient of refusing to make the offer to United, or refusing to advance any funds to American. The question remains whether Sabo and Pegram were under any duty in this regard.

At any rate, it has now been conclusively established that the only relevant period for purposes of considering any such duties was that which ended with the transfer of the assets to Kelly at about 5 p.m., October 18, 1957.

2. There Is No Basis in the Findings of Fact or Conclusions of Law, or in the Law or the Evidence, for Imposition of Liability Upon Sabo and Pegram for Breach of a Fiduciary Duty Owed by Them to United as Controlling Shareholders on October 18, 1957 (Referring to Pages 84 through 87 of Appellees' brief).

Appellees attempt now, for the first time, to bring Sabo and Pegram in under the controlling shareholders theory, as expounded in *Consolidated Rock Products Co. v. DuBois,* 312 US 510, 61 S. Ct. 675 (1941). The District Court did not purport to find Sabo and Pegram liable on this theory with regard to the events of October 18, 1957, for the very obvious reason that at the time United accepted the offer and transferred its assets to American in exchange for the latter's stock, *neither they nor American had any* stock interest in United. That the District Court did not so intend is perfectly clear from a full reading of its Supplemental Conclusion 13, portions of which are quoted out of context on Pages 85 and 87 of Appellees brief.

"S.C. 13: Sabo, Pegram and Landoe not only assisted Kelly in breaching the fiduciary duty he owed to United and to the minority shareholders by reason of his owning a controlling interest, but, also, assisted Croydon, Niesz, and Ballantyne in breaching the fiduciary duties they, respectively, owed United as directors of United. Consequently, Sabo, Pegram and Landoe are liable for having assisted a fiduciary breach his duties as well as having themselves breached the fiduciary duty they owed to United by reason of being directors of American." (Tr. 1739)

If one fact has been entirely undisputed throughout this litigation, it is that Kelly was in control of United at all relevant times. Kelly consistently manipulated the various Boards of Directors, and it was Kelly who prompted the corporate action taken by United on October 18, 1957, and accepted the offer made by American. The fact of Kelly's control was stipulated in the pre-trial order (Tr. 236; Paragraphs 48 and 49), was reaffirmed in the original Findings of Fact (Tr. 334-335; Findings of Fact 10 and 13), and Conclusions of Law (Tr. 350-351; Conclusions of Law 14 and 15), and was stated once again in Supplemental Finding 25 (Tr. 1728) and in Supplemental Conclusion 13 above quoted.

The domination of Kelly necessarily continued until such time as he finally endorsed and delivered his stock in United to American at the end of the day on October 18, 1957 (Exhibit 58; Tr. 662). Certainly Niesz, Croydon, and Ballantyne, owning and representing no stock in United, would not long have remained on the Board of Directors of that corporation if at the 4:15 p.m. meeting on October 18, 1957, they had refused to do Kelly's bidding by transferring the assets to American in exchange for the stock.

Nowhere in the Findings and Conclusions is there any reference to Sabo and Pegram as having any stock control over United at the time of its wrongful action. Any such finding or conclusion would be directly contrary to all of the evidence. Supplemental Finding 26 cannot reasonably be construed to include such a finding. Supplemental Finding 26 states as follows:

> "SF 26: Sabo, Pegram, Landoe, on October 18, 1957, owed a fiduciary duty to United by reason of their being Directors of American." (Tr. 1728)

This conclusory finding does not appear to be in compliance with requirements of Rule 52(a), Federal Rules of Civil Procedure, and with the holding of this Court in *National Lead Co. v. Western Lead Products Co.*, 291 F. 2d 447 (1961), wherein it stated at Page 451:

> "It is the duty of the District Court to find the facts. Rule 52(a), Federal Rules of Civil Procedure, 28 U.S. C.A. The findings should be so explicit as to give the appellate Court a clear understanding of the basis of the trial Court's decision, and to enable it to determine the ground on which the trial court reached its decision. See *Welsh Co. of California v. Strolee of California*, Supra.
>
> "It is not the proper function of this Court to engage in a process of assuming basic findings of fact upon which the conclusions of the District Court may have been reached, and then testing these assumed fact findings under the clearly erroneous provisions of Rule 52(a)."

We understood the finding, such as it is, to relate to either or both the alternative grounds advanced by Appellees and expressly adopted by the District Court, both of which are discussed herein under Section 4 of this brief. Upon this understanding, we presented our argument at

pages 28 to 48 of our opening brief, to the effect that the finding was based upon an erroneous view of the law and was contrary to the weight of the evidence. We still so contend, and we assert that, in their argument at pages 84 to 87 of their brief, Appellees are reading into this finding something which simply is not there. Since it has been established that, upon receipt of the assets by Kelly, the loss was complete, the control which American might thereafter have exercised over United has no relevance to this litigation.

The question of control is inseparable from the issue of knowledge, which will hereafter be discussed. Potential control over a corporation by reason of stock ownership is of no significance until such time as the dominant shareholder becomes aware of his position and takes advantage of his power. It is only the *abuse* of control, not its mere possession, which subjects one to liability as a fiduciary.

Nothing in *Consolidated Rock Products Co. v. DuBois*, or in any other decision cited by Appellees, would extend the fiduciary duty therein described to directors of the controlling corporation simply by virtue of their status as directors. Since there is no basis in the findings or conclusions for Appellees' assertion that Sabo and Pegram, acting through American, controlled the corporate actions taken by United on October 18, 1957, the argument at pages 84 through 87 of Appellees' brief is not well taken.

3. Neither Sabo nor Pegram Had, or Should Reasonably Have Had, Any Knowledge of Their Election as Directors of United on October 18, 1957, or of Any Improprieties in the Transactions Which Occurred on That Date (Referring to Pages 103 through 107 and to Pages 87 through 102 of Appellees' brief).

In spite of some suggestions to the contrary, we do not suppose that Appellees seriously contend that Sabo and

Pegram, in Montana on October 18, 1957, can be held vicariously liable in this action unless they had some knowledge, actual or constructive, of the events which occurred in Phoenix on that date and of the legal relationships which purportedly arose out of those events.

We have contended throughout that there is no competent evidence to support the findings that Sabo and Pegram had or should have had knowledge of any of these matters. Appellees have failed to support the affirmative of these propositions. The full extent of Appellees' compliance with Rule 18(3) of this Court is indicated by the following table, which sets forth each reference to the record or to exhibits made by Appellees in their response to our opening brief.

Testimony:

Sabo: Tr. 825; 835-842; 847; 852; 865-869; 876-880; 894; 906; 914-916.

Landoe: Tr. 1108.

Albert B. Turner: Tr. 762.

Exhibits:

101	Telegram, October 14, 1957 (Set forth in full as Appendix A to our opening brief herein)
F-12	Letter, October 22, 1957
F-13	Letter, November 5, 1957
50-A	American preincorporation agreement
50-N	American minutes, October 18, 1957
50-P	American minutes, November 18, 1957
D-1 and F-8-1	Tape and transcript of American meeting, February, 1958
5-G	United minutes, 4:00 P.M., October 18, 1957
5-H	United minutes, 4:15 P.M., October 18, 1957 (Set forth in full as Appendix B to our opening brief in No. 17114)

We shall not attempt to analyze here the twenty-six pages selected by Appellees from the testimony of Dr. Sabo. A careful examination of these references will afford no basis for Appellees' assertion either that Sabo actually admitted knowledge of his supposed involvement in the transaction or that he was lying when he denied such knowledge. The answer given by him at Page 876 of the Transcript, to the effect that he knew at the time of the preorganization meeting of American that he was to be a Director of United, was clearly and simply a mistake. Sabo's immediate correction of this error (Tr. 877), taken together with all his other testimony, as well as the statements of all others concerned (see pages 18 through 27 of our opening brief herein, together with pages 4 through 6 of our reply brief in No. 17114), must establish conclusively that the admission relied upon by Appellees is without probative value. Appellees have yet to specify the "testimony of Pegram, and others, and certain exhibits," referred to in Supplemental Finding 29; and certainly no great weight can be given to Dr. Sabo's demeanor in branding him a liar two years after he testified.

The cited testimony of Sabo does not support the challenged findings.

As for the testimony of Landoe, at Tr. 1108, it adds nothing of significance. Landoe merely relates his receipt of the telegram of October 14, 1957, and states that he explained it to Dr. Sabo, "To the best of my ability." (Tr. 1108)

The reference to the testimony of Turner, the witness from the First National Bank of Arizona, at Page 762 of the record, seems to be intended to support the implication that Sabo's transmittal of $52,000.00 on October 18, 1957, showed that he knew more of the events of that date than he admitted. Appellees would attach some dark significance

to the fact that $52,000.00 arrived from Sabo on the very day of the exchange. We are not told, however, how Sabo might have learned that October 18th would be the crucial date. Certainly none of the participants informed him. They were not aware themselves until that morning that the transaction would close that day (Tr. 718-719).

Appellees seem to have become confused with regard to the funds received by American from Sabo. On page 91 of their brief the statement is made that "he had advanced only $52,000.00 to American through October 18, 1957," while on the following page we are told that on October 18, 1957, American's "only assets were those purchased with the $23,000.00 sent by Sabo prior to October 17, 1957." The facts, as shown by the record, are that $40,000.00 was sent by Sabo to Croydon prior to October 17, 1957 (Tr. 924-925); $52,000.00 was received on October 18, 1957; and the final $23,000.00 of Sabo's $115,000.00 investment was sent on October 28, 1957 (Tr. 762-763). Although the relevance of these facts is doubtful, this is a correct statement of the record.

Of the eight (8) exhibits mentioned by Appellees and set forth in the table above, all but the first are of questionable relevancy, for reasons as follows: Exhibit F-12 is a letter, dated October 22, 1957, when, as the District Court found, nothing could have been done (Supplemental Finding 24); the letter makes no mention of directorships in United. Exhibit F-13 is another letter, dated November 5, 1957, from Croydon to Landoe, as to which all of the above also applies. Exhibit 50-A is a preincorporation agreement for American which contains no reference whatever to United or to the matter of directorships in any corporation other than American. Exhibit 50-N is the minutes of a director's meeting purportedly held by American on October 18, 1957,

when both Sabo and Pegram were in Montana, wherein it was resolved that the offer of shares would be made to United; there is no indication of who controlled United or who were its directors. Exhibit 50-P is the minutes of a later meeting of the American Board, purportedly held November 18, 1957; Sabo was not present. Exhibits D-1 and F-8-1 are a tape recording and transcript of an American meeting held in February, 1958, to discuss commissions paid to Croydon. Exhibits 5-G and 5-H are minutes of the critical meetings of the United Board, held October 18, 1957, at 4:00 p.m. and 4:15 p.m. It is undisputed that neither Sabo or Pegram ever saw or signed these minutes (Tr. 876-877).

Exhibit 101, to which Appellees have referred on Pages 90, 91, and 105 of their brief, is without question the most significant item in evidence regarding the liability of Sabo and Pegram. This is the telegram, dated October 14, 1957, sent by Niesz, Ballantyne, and Croydon to Landoe to outline the proposed transaction with United. It is set forth in full as Appendix A to our opening brief herein.

The record is entirely clear that this telegram embodied all that Sabo and Pegram knew of the United proposal prior to October 18, 1957, or for some time thereafter. This telegram was the first notice to Sabo or Pegram of the existence of United, although Landoe had had a telephone conversation on this subject with Croydon on the preceding day.

Appellees have relied on Exhibit 101 to support all of the critical findings made and inferences drawn by the District Court as to the actual or constructive knowledge of Sabo and Pegram on or before October 18, 1957. For this reason, we ask that the Court examine the Exhibit carefully. Under these circumstances, we submit that the weight

to be given this evidence is a matter peculiarly susceptible to appellate review. Since Sabo and Pegram had no previous knowledge of the transaction, their entire understanding during the relevant period is limited to that which is contained in, or reasonably inferred from, this document. If the sequence of events which actually did occur on October 18, 1957, is not clearly described or fairly inferable from this telegram, then the judgment entered against Sabo and Pegram must be reversed.

Appellees' analysis of Exhibit 101 has taken the following course. After discussing the telegram on Pages 91 and 92 of their brief, they state their position as follows:

> "Certainly both Sabo and Pegram, and Landoe were and are well aware that neither United nor any other corporation, dealing at arm's length and in the hands of those looking out for United's interests, would permit United to transfer $314,794.19 of its cash, bonds, and other liquid assets for 349,000 shares of stock in American, a corporation which had been formed at 4:45 P.M. the previous day and whose only assets were those purchased with the $23,000 sent by Sabo prior to October 17, 1957."

Then, at Page 95, they inquire:

> "* * * can it reasonably be concluded that educated and experienced men such as Sabo, Pegram and Landoe, a lawyer, who advised the former, did not have knowledge that Croydon, Niesz and Ballantyne, *as directors of United owed* a fiduciary duty to United and that such a duty would be breached if they actually did what they said they were going to do in the telegram of October 14, 1957?" (Emphasis supplied.)

And at Page 106, they conclude:

> "* * * Thus, he knew that since he was the only person putting money into American, the assets of United

would have to be taken by American acting through its directors, who were to be directors of United."

Thus, simply by rhetoric, Appellees have first bridged the gap from the bare words of the telegram to the assumption that Sabo and Pegram must have been "well aware" on October 14, 1957, that antagonistic forces had control of United; then from this to the further assumption that these antagnostic forces were none other than Croydon, Niesz, and Ballantyne; and then on to the final conclusion that Sabo and Pegram, on October 14, 1957, must have known that the Board of United would, on October 18, 1957, be composed of Directors of American, who would proceed to impair United by purchasing stock in American, and that these dual directors would thereby ruin United and American and Sabo himself.

A more reasonable assumption is that Dr. Sabo was duly concerned for the safety of his $115,000.00 investment, and that had he known or suspected what was about to occur, he would have made every possible effort to prevent it, if only for his own financial interests.

Appellees' chain of reasoning breaks down with the very first link. The telegram does not describe a transaction which is prima facie wrongful or antagonistic to the best interests of United. Certainly the stock of a newly formed corporation such as American has no intrinsic value, but it immediately acquires value when the corporation receives the consideration for which the stock is issued. And no harm is done if the consideration thus received is immediately exchanged for other assets of equal value. In such a situation, value imparts value. This is a perfectly simple concept without which no corporation could ever be capitalized.

The problem in this instance stems from the fact that the transfer of assets from United resulted in the legal impairment of that corporation. This result followed only by reason of the provisions of the Arizona insurance code, under which stock in a new corporation such as American cannot be a proper admitted asset for the balance sheet of an insurance corporation. It is not contended that Sabo and Pegram knew of this legal provision, or that they knew that United had insufficient surplus to make such an investment in non-admitted assets. This fact, which of course is not mentioned in the telegram of October 14, 1957, caused the United stock acquired from Kelly to lose its value, with the ultimate effect of rendering United's investment worthless. This is a result that simply does not follow, and is not reasonably to be anticipated, from the statements in the telegram seen by Sabo and Pegram.

The second link in Appellees' reasoning is that the fact that the offer was to be made to United by American must necessarily signify that United was then in the hands of pirates. The logic of this proposition escapes us. It is equally reasonable to suppose that United was being administered by responsible directors who, upon examining the proposal, would simply reject it.

Finally, there is no logical basis for the conclusion, that, if antagonistic persons were in control of United, those persons were the respected associates of Sabo and Pegram. Nothing in their prior conduct or in the telegram itself would suggest this possibility. Appellees' chain of inference from Exhibit 101 is without support in logic, law, or in the evidence.

Acknowledging this Exhibit to be the sole direct evidence of the information communicated to Sabo and Pegram prior to October 18, 1957, regarding the impending transaction

with United, the Supplemental findings based upon what Sabo and Pegram knew or should reasonably have known on that date are clearly erroneous and must be set aside.

This, then, is the sum and substance of the evidence relied upon by Appellees to support the challenged findings as to the knowledge, actual or inferable, of Sabo and Pegram on October 18, 1957. The burden of proof on these issues fell upon Appellees. Appellees' failure to comply with the rules of this Court lends additional substance to our contention that the challenged findings are without support in the record.

4. Neither Sabo nor Pegram Is Liable to United as a Director of American on October 18, 1957, for:

a. Knowing Participation with Fiduciaries in the Breach of Fiduciary Duties (Referring to Pages 87 through 97 of Appellees' brief);

b. Negligence in Failing to Supervise the Activities of the Other Officers and Directors of American on That Date (Referring to Pages 97 through 102 of Appellees' brief).

Irving Trust Co. v. Deutsch, CA N.Y., 73 F.2d 121 (1934), remains the leading exposition of the doctrine applying to corporate directors, or those who conspire with them, liability for participation in the breach of a trust. Appellees have urged that our construction of the decision in *Irving Trust Co. v. Deutsch* is incorrect, and that a proper reading of the principles therein set forth justifies the imposition of liability upon Sabo and Pegram. Rather than re-argue the substance of that decision, we shall leave further analysis of *Irving Trust* to the Court, if it be deemed necessary. We stand upon our interpretation of the decision, as set forth at Pages 33 through 38 of our opening brief herein. Actual participation, knowledge, and profit are indispensable elements in an action to impose liability under this theory. Appellees have not seriously contro-

verted this construction. Rather, they have attempted to infer knowledge from the telegram (Exhibit 101) and to infer participation from the fact that Sabo's money was used (and lost) in the same transaction.

The real question posed by Appellees' discussion of this point is whether the telegram itself gave Sabo and Pegram notice that a breach of trust was contemplated. As we have previously noted, Appellees have asserted that the knowledge imparted to Sabo and Pegram by the telegram—that American was to issue stock to United for assets which were in turn to be used by American to purchase stock in United—must have alerted them to the fact that something improper was about to take place. All of Appellees' analysis of the evidence is necessarily premised upon this assumption.

We do not contend that Sabo and Pegram had any understanding other than that the assets of United, received in exchange for American stock, would serve as the purchase price for the stock interest in United to be acquired by American. The position of Sabo and Pegram is, however, that this fact in itself imports no evil intent and no grounds for suspicion that a disaster was about to occur. There is nothing patently wrongful about a transaction in which one corporation, newly formed, issues its stock to an existing corporation in consideration for valuable assets of that corporation, and then exchanges these assets for a controlling stock interest in the latter corporation. We have discussed this matter in the preceding section of this brief, and we shall not belabor the point further.

Appellees have asserted that we have not related our discussion of the *Irving Trust* decision to the facts of this case. Therefore, to dispel any doubts which may remain, our position regarding the four elements of liability is set forth as follows:

1. *Actual participation with the unfaithful fiduciary.* The conduct of Sabo and Pegram in taking no action after the receipt of the telegram of October 14, 1957, does not constitute participation in the breach of trust. The fact that Niesz, Croydon, and Ballantyne gave Sabo's money to Kelly, along with the United assets, would justify denominating him as an additional victim, rather than as a participant in the breach.

2. *Knowledge that the co-participants owe a fiduciary duty.* As we have repeatedly urged, there is no suggestion, other than in the unsupported arguments made by Appellees, that Sabo and Pegram had any knowledge that those with whom they were associating in American (Niesz, Croydon, and Ballantyne) would occupy a fiduciary relationship to United at any time relevant to the transaction described in the telegram of October 14, 1957.

3. *Knowledge that the conduct of the co-participants amounts to a breach of fiduciary duty.* The transaction described in the telegram is not wrongful on its face. Since Sabo and Pegram manifestly did not have knowledge of those additional facts which would have informed them of the hazard to United, this element is also lacking.

4. *Realization of profits by reason of the breach of duty.* One does not incur liability simply by losing money in a transaction in which another is victimized by a fiduciary. On Page 95 of their brief, Appellees state:

> "* * * Sabo obtained 35.149% of the stock of United from Kelly, worth $325,136.48 (R. 236) through his corporation American, as did Pegram, for an investment of only $52,000. which he had sent to American."

This statement alone contains at least four clear misstatements of fact. First, Sabo did not obtain the stock; it was acquired by American, in which United had a large stock

interest. Second, the stock was not worth $325,136.48; if it had been, no one would have been hurt; it is only the finding that this stock was worthless which justifies the conclusion that United was injured. Third, American was not Sabo's corporation; he was one of several stockholders therein, including United. Fourth, Sabo had invested $92,000.00 by October 18, 1957, and $115,000.00 by October 28, 1957, all of which was lost as a result of the wrongful acts of Niesz, Croydon, Ballantyne, and Kelly.

Applying the law, as expounded in *Irving Trust Co. v. Deutsch,* to the facts shown by the record, it is clear that Sabo and Pegram can not be held liable for knowing participation in the breach of fiduciary duties which occurred on October 18, 1957.

b. Appellees have repeatedly claimed that Sabo and Pegram may be held liable for the acts of Niesz, Croydon, and Ballantyne, either on grounds that the knowledge of the Arizona associates may be imputed to those in Montana, or upon the theory that Sabo and Pegram are legally responsible for failing to supervise those acts of the officers of American occurring between the time of the formation of American at 4:45 P.M., October 17, 1957, and the time the assets of United were turned over to Kelly at 5:00 P.M., October 18, 1957.

In response to these contentions, we have urged:

1. Knowledge of one director can not be imputed to another for purposes of holding the latter liable for an injury caused by the corporation (Argued at Pages 38 through 44 of our opening brief).

2. A director can not be held liable to one injured by his corporation through the negligence of the officers or agents of the corporation, unless the director himself actually caused or participated in the wrong as an individual;

in such event he is held liable for his own wrongdoing, not because of his status as a director (Argued at Page 44 of our opening brief herein, and at Pages 67 through 75 of our opening brief and No. 17114).

c. When a corporate act involving difficult questions of law has been carried out under the supervision of qualified attorneys, reliance upon advice of counsel is a good defense to an action against the directors for damage resulting from the illegality of the act (argued at Pages 45 through 48 of our opening brief).

Appellees' answer to the first and second of these points, as set forth at Pages 97 through 100 of their brief, is simply to beg the question by asserting that Sabo *did* have prior or contemporaneous knowelge of the events of October 18, 1957, and that he *did* actually participate therein. If this were so, then Appellees would be entirely correct in their assertions that the authorities which we have cited are inapplicable. All of these decisions are cited solely for the proposition that directors of a business corporation are responsible to third parties only for their own actions or knowledge, and these authorities have no relevance whatever to a situation in which the directors affirmatively know of and participate in the wrongful act. However, by taking this position and failing to confront the numerous decisions upon which our arguments are based, Appellees appear to concede that *lacking* actual knowledge of the relevant facts, and *lacking* personal involvement in the improper activities, there is no legal basis for imposing liability upon Sabo and Pegram. The argument of Appellees on these points is directed entirely to the question of what Sabo and Pegram knew or should reasonably have known on October 18, 1957, all of which has been fully considered above.

Appellees have made no showing whatever that Sabo and Pegram can be held liable as directors of American for the

acts of the other officers and directors of that corporation. To the extent that the judgment of the District Court is based upon such a theory, it is clearly against the weight of the evidence, is based upon an erroneous view of the law, and must be reversed.

Finally, there is the question of whether Sabo and Pegram had a right to rely upon the advice and guidance of Arizona attorneys in implementing the transaction described in the telegram of October 14, 1957. In response to our discussion of this issue, Appellees have countered with the argument that this defense is unavailable to Sabo and Pegram because there has been no proof that the transaction was "approved" by attorneys specifically representing United, or by the State Insurance Commission or Securities Division. This of course is true, and we have never made any assertions to the contrary. However, this does not preclude application of *Gilbert v. Burnside,* 13 App. Div. 2d 982, 216 N.Y.S. 2d 430; affirmed 11 N.Y. 2d 960, 183 N.E. 2d 325 (1962), discussed at length in our opening brief at Pages 45 through 48.

A reading of the several decisions in *Gilbert v. Burnside* will show that the issue in that case, with regard to the Defendant directors, was not whether the proposed merger had been *approved* by the attorneys for the adverse parties or by the proper state authorities. Rather, the question was whether these directors, realizing that the pending transaction involved difficult questions of Pennsylvania corporate law, had discharged their duty of care by referring the matter to competent Philadelphia attorneys and relying upon the judgment of counsel in proceeding with the reorganization. The holding of the Appellate Division, upheld by the Court of Appeals, was that the reliance upon counsel under the circumstances was justifiable, even though counsel were ultimately proved wrong. The New York courts thus recog-

nized that there are times when the proper discharge of a director's duty requires him to place his trust in attorneys to determine the proper course of corporate action. Appellees do not deny that the transaction was effectuated under the direct supervision of attorneys purporting to represent all interested parties; or that Sabo and Pegram, as investors and directors in American, were relying upon Goss, the attorney for that corporation, to see that the transfers were properly made; or that Sabo received all of his information regarding the United matter through Landoe, who discussed and interpreted the telegram of October 14, 1957. Of course, Sabo and Pegram did not know, and had no way of knowing, that Goss himself, upon whom they were relying, acted as a director of United to approve the purchase of the American stock.

Although *Gilbert v. Burnside* need not necessarily control this case, its reasoning is persuasive in light of the many factual similiarities. Sabo and Pegram, having relied upon counsel for the proper implementation of this exchange, were not negligent as directors of American.

5. Neither DePinto nor Duhame Is Entitled to Contribution or Indemnity From Sabo or Pegram With Regard to Any Recovery Had Against Them in This Action. (Referring to Pages 37 and 38 of the Brief of Appellant DePinto)

Appellants DePinto and Duhame urged, in their appeal in No. 17114, that they should be entitled to indemnification from Sabo and Pegram for any judgment recovered against them in this action. Their argument is set forth in the opening brief of Appellant DePinto in No. 17114, at Pages 50 through 54, and is answered in our reply brief therein, at Page 17 through 20. The theory then advanced was that although DePinto might be liable in negligence for the losses incurred by United, the Arizona Supreme Court, in *Busy Bee Buffet v. Ferrell,* 82 Ariz. 192, 310 P.2d

817, has recognized a distinction, in proper cases, between "active" and "passive" negligence, and "primary" and "secondary" tort liability. DePinto asserted that this distinction was applicable to him and would justify indemnity in his favor against Sabo and Pegram, in spite of the District Court's finding that no contribution would be allowed among the joint tort feasers.

On remand the District Court again considered this matter upon the identical cross-claims filed by DePinto and Duhame. In its memorandum decision (Tr. 1711), the Court acknowledged *Busy Bee Buffet v. Ferrell*, and held:

> "The crossclaims of DePinto and Duhame are predicated on the contention that their liability, if any, is vicarious and secondary to that of the defendants against whom the cross claims are asserted. The named defendants cite an Arizona case discussing primary and secondary tort liability and authorizing recovery of contribution or reimbursement to those held in the second category from those in the first category. *Busy* Bee Buffet v. Ferrell, 82 Ariz. 192; 310 P. 2d 817. Under the particular facts of this case neither DePinto nor Duhame qualifies as having only secondary liability as defined and applied in the cited decision. Both DePinto and Duhame are found and held to be primary joint tort feasors and may not recover contribution under Arizona law. For these reasons the motion of defendants Sabo, Pegram and Landoe to dismiss the crossclaims of defendants DePinto and Duhame is hereby granted."

The language of the District Court leaves no doubt that the criteria set forth in *Busy Bee* were fully considered, and upon such consideration the Court determined as a matter of fact and of law that neither DePinto nor Duhame is entitled to indemnity or contribution from Sabo or Pegram. The points raised by DePinto in No. 17114 have been fully answered in our reply brief in that appeal and by the

decision of the District Court above quoted. Since no reason is shown why this latter determination should be set aside, the decision of the District Court should be affirmed in this respect, regardless of the ultimate outcome on the other issues.

CONCLUSION: A CRITICAL ANALYSIS OF APPELLEES' APPROACH

All of the findings and conclusions of the District Court, and all of the arguments of the Appellees, turn upon the inter-relationship of knowledge and duty. Throughout this litigation, when we have argued that certain critical facts were not known by Sabo and Pegram, Appellees have responded by stating broadly that the law does not require such knowledge. On the other hand, when we have cited legal authority to the effect that certain duties do not arise when the party affected has no knowledge of the relevant facts, Appellees have peremptorily dismissed such authorities as inapplicable, since, they say, Sabo and Pegram did have such knowledge. In spite of this elusive quality of Appellees' argument, the bald fact remains that we have been shown no evidence to support these factual assertions, and we have been cited to no authorities which fairly dispute our legal contentions. The findings, conclusions, and judgment of the District Court are clearly erroneous and must be set aside with directions to dismiss this action against Appellants Sabo and Pegram.

Respectfully submitted,

Botsford, Shumway & Wilson
Guy C. Wilson
Attorneys for Appellants
Sabo and Pegram

CERTIFICATION

I certify, that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing is in full compliance with those rules.

GUY C. WILSON

No. 18245

In the

United States Court of Appeals

For the Ninth Circuit

ANGUS J. DEPINTO, HJALMAR B. LANDOE, FRANCIS I. SABO and EDWIN B. PEGRAM, ELMER W. DUHAME,

Appellants,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and JOHN S. GORSUCH and ALBERT J. DOIG,

Appellees.

Petition of Elmer W. Duhame for Rehearing

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No. 18245

In the

United States Court of Appeals

For the Ninth Circuit

ANGUS J. DEPINTO, HJALMAR B. LANDOE, FRANCIS I. SABO and EDWIN B. PEGRAM, ELMER W. DUHAME,

Appellants,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and JOHN S. GORSUCH and ALBERT J. DOIG,

Appellees.

Petition of Elmer W. Duhame for Rehearing

COMES NOW the Appellant ELMER W. DUHAME and respectfully petitions for a rehearing in the above entitled cause as to the issue of the reinstatement of the jury verdict only, upon the following grounds:

I.

That in the absence of a motion for a new trial by the plaintiff-appellee, the granting of a judgment N.O.V. does not have the effect of granting a new trial and such failure results in the loss of jurisdiction to grant a new trial.

II.

The issue of the inadequacy of the damages as to those defendants found guilty of a breach of their fiduciary capacity is not applicable to the defendant Duhame as he was exculpated from any liability or breach of fiduciary capacity or negligence by the verdict of the jury which should be reinstated as to the defendant Duhame.

III.

That in the interest of justice, in the event this cause is remanded to the United States District Court for the District of Arizona for a new trial, further proceedings herein shall be heard by a judge, other than the Honorable George H. Boldt, to be designated by the Chief Judge of this Circuit pursuant to Section 292(b), Title 28, U.S.C.

Respectfully submitted,

O'Connor, Anderson, Westover,
Killingsworth & Beshears
and
John P. Otto

By John P. Otto
1000 Central Towers
Phoenix, Arizona

Attorneys for Appellant,
Elmer W. Duhame

CERTIFICATE

I hereby certify that the Petition for Rehearing in my judgment is well founded and that it is not interposed for the purpose of delay.

O'CONNOR, ANDERSON, WESTOVER,
KILLINGSWORTH & BESHEARS
and
JOHN P. OTTO

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Attorneys for Appellant,
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No. 18,246

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA, APPELLANT

v.

STATE OF CALIFORNIA, APPELLEE

Appeal from the United States District Court for the Southern District of California, Central Division

BRIEF FOR THE UNITED STATES, APPELLANT

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INDEX

CITATIONS

Cases:

Cases—Continued Page

Cases—Continued Page

Constitution, Code and Statutes:

Constitution:

United States Code:

In the United States Court of Appeals for the Ninth Circuit

No. 18,246

UNITED STATES OF AMERICA, APPELLANT

v.

STATE OF CALIFORNIA, APPELLEE

Appeal from the United States District Court for the Southern District of California, Central Division

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BRIEF FOR THE UNITED STATES, APPELLANT

OPINION BELOW

The opinion of the district court (R. 21-37) is reported at 208 F.Supp. 861.

JURISDICTION

The United States filed this suit on April 10, 1962, for damages and costs of suppression of a fire allegedly resulting from negligence of employees of the State of California, invoking the jurisdiction of the district court under 28 U.S.C. sec. 1345 (R. 2-6). On April

30, 1962, the district court on its own motion dismissed the suit for lack of jurisdiction (R. 16-20). The United States filed notice of appeal on June 28, 1962 (R. 38), and invokes the jurisdiction of this Court under 28 U.S.C. sec. 1291.

QUESTION PRESENTED

Whether the district court has jurisdiction over an action for damages and fire suppression costs brought by the United States against the State of California.

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

The pertinent portions of Article III of the Constitution of the United States read as follows:

> Section 1. The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. * * *
>
> Section 2. The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;—to all Cases affecting Ambassadors, other public Ministers and Consuls;—to all Cases of admiralty and maritime Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between a State and Citizens of another State;—between Citizens of different States;—between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Cit-

izens thereof, and foreign States, Citizens or Subjects.

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

* * * *

28 U.S.C. sec. 1251, entitled "Original Jurisdiction" and part of the Chapter on the Supreme Court, reads as follows:

(a) The Supreme Court shall have original and exclusive jurisdiction of:

(1) All controversies between two or more States;

(2) All actions or proceedings against ambassadors or other public ministers of foreign states or their domestics or domestic servants, not inconsistent with the law of nations.

(b) The Supreme Court shall have original but not exclusive jurisdiction of:

(1) All actions or proceedings brought by ambassadors or other public ministers of foreign states or to which consuls or vice consuls of foreign states are parties;

(2) All controversies between the United States and a State;

(3) All actions or proceedings by a State against the citizens of another State or against aliens.

28 U.S.C. sec. 1345, entitled "United States as plaintiff," reads as follows:

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

STATEMENT

On April 10, 1962, the United States filed a complaint alleging that negligence of employees of the State of California had caused a fire burning over some 24,000 acres in the Angeles National Forest and resulting in a loss to the United States of $479,-194.43 (R. 2-6). According to the complaint, the State Division of Highways, using prison inmate laborers, was building a highway within the forest. One of the prisoners, a member of a blasting crew, lit a fire within a warming stove at the top of a high pitched slope in a wooded and brush-covered area while a strong wind was blowing. An hour and a half later, the crew foreman took his crew from the construction site because of the increasing velocity of the wind, but, although he knew there was a fire in the stove, he failed to instruct anyone to put it out. Shortly thereafter, the wind blew the stove over, and the fire escaped and spread into the brush and forest. The damages claimed included $455,194.43 for fire suppression costs and $24,000 for damages to the forest resources. In a second count, the United States charged that the Division of Highways had

undertaken to extinguish the fire but had negligently and carelessly failed to do so. The complaint also alleged that the United States had presented a verified claim for its loss to the State Board of Control for the State of California.

On April 17, 1962, the district court issued a *sua sponte* order to show cause why the action should not be dismissed for lack of jurisdiction (R. 7). The complaint had alleged jurisdiction under 28 U.S.C. sec. 1345. After a hearing on April 30, 1962 (R. 15), the district court dismissed the suit for lack of jurisdiction (R. 16-20) and this appeal followed (R. 38).

Although the order of dismissal stated that the State of California is immune to negligence suits where the particular public activity involved is governmental in character (R. 16-17, Par. 2), and that the building of a highway is governmental in character (R. 17, Par. 3), the dismissal of the suit seemed to rest on the ground that Congress has not vested the district courts with jurisdiction over States as defendants in cases not involving the adjudication of property rights (R. 19-20, Pars. 8, 9). The district court later filed an opinion (R. 21-37) spelling out in more detail why 28 U.S.C. sec. 1345 should not be construed as granting the district courts jurisdiction over every kind of suit the United States might wish to bring against a State (see especially R. 32-35).

SPECIFICATION OF ERROR

The district court erred in dismissing this suit by the United States against the State of California for lack of jurisdiction.

SUMMARY OF ARGUMENT

Whether a federal court has jurisdiction in a given case depends on whether the federal judicial power extends to the case and whether Congress has given the particular court jurisdiction to exercise that power in the case. The three points of this brief will demonstrate (1) that the judicial power of the United States embraces suits by the United States against a State, (2) that Congress has given the district courts jurisdiction over such cases, and (3) that a State's immunity to private suit under its own law is not a barrier to such a suit.

I

Article III of the Constitution extends the judicial power of the United States to "Controversies to which the United States shall be a Party," and there exists no exception of cases where a State is defendant. The Supreme Court has frequently entertained suits by the United States against a State, even bypassing the presence of a federal question as a jurisdictional basis to hold that the judicial power extends to such suits simply because the United States is a party. The great variety of causes of action in these cases clearly demonstrates that the nature of the cause of action in a given case is immaterial when the United States is a party.

II

Although Article III of the Constitution gives the Supreme Court original jurisdiction over suits involving States, it does not give that Court exclusive jurisdiction over such suits. Congress, in 28 U.S.C. sec. 1251(b), has stated that this jurisdiction is original but not exclusive, and in 28 U.S.C. sec. 1345 it gives the district courts general jurisdiction over suits where the United States is plaintiff, "except as otherwise provided by Act of Congress." Since it is no longer "otherwise provided" that the Supreme Court has exclusive jurisdiction over suits by the United States against States, Section 1345 gives the district courts jurisdiction over such suits concurrent with that of the Supreme Court, and this Court has so held. Furthermore, it is quite clear from Supreme Court holdings at a time when it did have exclusive jurisdiction over such suits that it is not necessary for Congress to specify in every jurisdictional statute creating concurrent jurisdiction that States may be made defendants under it.

III

The Constitution establishes the judicial power of the United States, and the Constitution and the Judicial Code give various federal courts jurisdiction to exercise it. If federal jurisdiction exists in a given case, it cannot be modified by state law. Thus any immunity to suit California may have under its own law is irrelevant to the existence or non-existence of federal jurisdiction here. Any consent which it was necessary for California to give to suits by the United

States it did give when it accepted the constitutional scheme by joining the Union.

ARGUMENT

Jurisdiction of a particular federal court over a given case rests first on the existence of federal judicial power as granted by Article III of the Constitution, and second on the distribution of that power by Article III and by statute.[1] The court below erred by confusing the existence of judicial power with its distribution, by creating exceptions to the judicial power and its own jurisdiction for which there is no constitutional or statutory basis, and by introducing the wholly irrelevant matter of a State's immunity to suit by its citizens. We will show in Point I that Article III of the Constitution extends the federal judicial power to suits by the United States against a State without qualification as to subject matter. We will show in Point II that the Constitution gives the Supreme Court original but not exclusive jurisdiction over suits involving States, and that Congress has given the district courts concurrent jurisdiction over suits between the United States and a State, such as the case at bar. Finally, in

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[1] "Judicial power" and "jurisdiction" are not necessarily synonymous terms, though they are often used interchangeably. For example, Article III, Section 2, of the Constitution extends the judicial power of the United States to cases "between Citizens of different States," but Congress has given the district courts jurisdiction over such cases only where the amount in controversy exceeds $10,000. 28 U.S.C. sec. 1332.

Point III, we will show that questions of California's immunity to suit under state law have no bearing whatsoever on the existence or non-existence of federal jurisdiction.

I

The Judicial Power of the United States Extends To Suits By the United States Against a State

The federal judicial power embraces the present case simply by virtue of the presence of the United States as a party. Article III of the Constitution, the source of the judicial power of the federal courts, extends that power to nine different categories of cases and controversies, the fourth of which is "Controversies to which the United States shall be a Party." As we shall now demonstrate, no exception to the plain meaning of this clause exists because the other party to the suit is a State, irrespective of the nature of the cause.

Apparently the first suit brought by the United States against a State as defendant was *United States* v. *North Carolina*, 136 U.S. 211 (1890), a common law action of debt. Although no one argued the jurisdictional question in the *North Carolina* case, the Supreme Court was aware of the problem and assumed that it had jurisdiction, as the Court itself made clear two terms later in *United States* v. *Texas*, 143 U.S. 621 (1892). There, answering its own question as to whether the framers of the Constitution had failed "to provide for the judicial determination of controversies arising between the United

States and one or more of the States of the Union," the Court said (143 U.S. at 642):

> This question is in effect answered by *United States* v. *North Carolina*, 136 U.S. 211. That was an action of debt brought in this court by the United States against the State of North Carolina, upon certain bonds issued by that State. The State appeared, the case was determined here upon its merits, and judgment was rendered for the State. It is true that no question was made as to the jurisdiction of this court, and nothing was therefore said in the opinion upon that subject. *But it did not escape the attention of the court, and the judgment would not have been rendered except upon the theory that this court has original jurisdiction of a suit by the United States against a State.* [Emphasis added.]

Because Texas had argued the jurisdictional question and North Carolina had not, the Court considered it proper to deal with the question on its merits in the *Texas* case instead of simply relying on the *North Carolina* case as resolving it. After setting out Section 2, Article III, the Court showed how the United States could sue Texas under its provisions (143 U.S. at 643):

> It is apparent upon the face of these clauses that in one class of cases the jurisdiction of the courts of the Union depends "on the character of the cause, whoever may be the parties," and, in the other, on the character of the parties, whatever may be the subject of controversy. *Cohens* v. *Virginia*, 6 Wheat. 264, 378, 393. The present suit falls in each class, for it is, plainly, one arising under the Constitution, laws

> and treaties of the United States, and, also, one *in which the United States is a party. It is, therefore, one to which, by the express words of the Constitution, the judicial power of the United States extends.* [Emphasis added.]

The classes of cases referred to are those described in *Cohens* v. *Virginia*, 6 Wheat. 264, 376-377 (1821):

> The second section of the third article of the constitution defines the extent of the judicial power of the United States. Jurisdiction is given to the courts of the Union, in two classes of cases. In the first, their jurisdiction depends on the character of the cause, whoever may be the parties. This class comprehends "all cases in law and equity arising under this constitution, the laws of the United States, and treaties made, or which shall be made, under their authority." This clause extends the jurisdiction of the court to all the cases described, without making in its terms any exception whatever, and without any regard to the condition of the party. If there be any exception, it is to be implied, against the express words of the article. *In the second class, the jurisdiction depends entirely on the character of the parties.* In this are comprehended "controversies between two or more states, between a state and citizens of another state," and "between a state and foreign states, citizens or subjects." *If these be the parties, it is entirely unimportant, what may be the subject of controversy.* Be it what it may, these parties have a constitutional right to come into the courts of the Union. [Emphasis added.]

The distinction between classes of cases is important here because this case falls into the class in which

the existence of judicial power rests upon the character of the parties.[2] In that respect, even if the present case could be partially distinguished from *United States* v. *Texas*, where there was a question "arising under the Constitution, laws and treaties of the United States," it cannot be distinguished from *United States* v. *North Carolina*, where there was no such question, i.e., no "federal question." Thus it is clear from *Cohens* v. *Virginia* and *United States* v. *North Carolina*, as approved by *United States* v. *Texas*, that the constitutional extension of the judiciary power of the United States to "Controversies to which the United States shall be a Party" embraces suits by the United States against a State, irrespective of the nature of the case.[3]

That the presence of a question arising under the Constitution, laws, or treaties of the United States

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[2] Because the presence of the United States clearly establishes jurisdiction, we need not discuss here the question whether the fact by itself that the subject matter of the action is the recovery of damage to federal property—the management of which Article IV of the Constitution vests in Congress—brings the case within the first category mentioned in *Cohens*.

[3] Since the nature of the case has no effect on the existence of judicial power resting on the presence of the United States, it makes no difference that the United States' allegations of negligence state an action sounding in tort. But it is interesting to note that the California Health & Safety Code, Sec. 13009, provides an action in debt for fire suppression costs. Cf. *People of California* v. *United States*, 307 F.2d 941 (C.A. 9, 1962). Thus, the United States' cause of action for such costs in the present case is indistinguishable from that in *United States* v. *North Carolina*, which was an action in debt.

is not essential to the existence of federal judicial power was even more firmly established in *Minnesota* v. *Hitchcock*, 185 U.S. 373 (1902), a suit to enjoin the Secretary of the Interior from selling Indian lands within the State of Minnesota. There the Court on its own motion raised the question of whether the case was one to which the judicial power of the United States extends. Passing other possible bases of jurisdiction, including the presence of a federal question, as unnecessary to the disposition of the case, the Court held that it had jurisdiction because the case was one "to which the United States may be regarded as a party. It is one, therefore, to which the judicial power of the United States extends." 185 U.S. at 384. The Court then demonstrated that the United States, not the Secretary of the Interior, was the real party in interest. The point to be noted was that the Court held that the controversy was within the federal judicial power solely because the United States was a party and not because of the character of the case.

The Supreme Court has never concerned itself with the character of the case or controversy—once it has determined that there is a case or controversy—in holding that it has jurisdiction over a suit between the United States and a State. Consequently, the district court in this case had no basis for believing that the United States can bring some kinds of suits but not others. It would unduly prolong this brief to discuss all the cases in which the Supreme Court has entertained a suit by the United States, but it

is instructive to list some of the causes of action in these cases:

> Suit for an accounting and to enforce a trust. *United States* v. *Michigan*, 190 U.S. 379 (1903).
>
> Suit to settle boundary dispute and to quiet title to a river bed. *Oklahoma* v. *Texas*, 258 U.S. 574 (1922) (United States intervened).
>
> Suit to cancel patents issued under a swampland grant. *United States* v. *Minnesota*, 270 U.S. 181 (1926).
>
> Suit to quiet title to river beds within State. *United States* v. *Utah*, 283 U.S. 64 (1931).
>
> Suit to quiet title. *United States* v. *Oregon*, 295 U.S. 1 (1935).
>
> Suit to enjoin interference with construction of a federal dam. *United States* v. *Arizona*, 295 U.S. 174 (1935).
>
> Suit to establish paramount federal authority with respect to building dams on certain rivers and to enjoin construction of a dam under state authority. *United States* v. *West Virginia*, 295 U.S. 463 (1935) (dismissed for lack of a controversy between the United States and the State.)
>
> Suit (brought in a district court) by the United States to recover a statutory penalty for violation of the federal Safety Appliance Act. *United States* v. *California*, 297 U.S. 175 (1936).
>
> Suit to have removed, as clouds on title, state tax liens on land purchased by Government. *United States* v. *Alabama*, 313 U.S. 274 (1941).
>
> Suit to establish federal title to land within State and to recover for oil which had been removed

and sold under a state lease. *United States* v. *Wyoming*, 331 U.S. 440 (1947).

Suit to declare rights in off-shore area and to enjoin trespass. *United States* v. *California*, 332 U.S. 19 (1947).

Suits to declare rights in off-shore area, to enjoin trespass, and for accounting. *United States* v. *Louisiana*, 339 U.S. 699 (1950); *United States* v. *Texas*, 339 U.S. 707 (1950).

The variety of causes of action and the decisions in the above cases demonstrate that the character of the suit has never been a material consideration in determining whether a particular suit was within the federal judicial power. There is no limitation to cases adjudicating property interests between sovereigns, as suggested in paragraph 8 of the district court's order (R. 19, cf. R. 33), nor to cases where the United States asks for protection and enforcement of its powers under the supremacy clause, U.S. Const. Art. VI, sec. 2, against encroachment by a State, as suggested in the district court's opinion (R. 29). Even if there were such limitations, it is difficult to see why suit for damage to a national forest is not a suit to protect a property interest.

Reference to the nature of a question in a case is necessary only when jurisdiction depends upon the presence of a federal question. Here, where jurisdiction rests on the presence of the United States, the nature of the question is immaterial. The case is plainly within Article III's extension of the judicial power to "Controversies to which the United States shall be a Party."

II

The Federal District Courts Have Concurrent Jurisdiction With the Supreme Court Over Suits By the United States Against a State

Once it is established that a particular case is within the judicial power of the United States, it next becomes necessary to determine what federal court has jurisdiction to exercise this power. Clause 2, Section 2, Article III, makes a partial distribution of the power and leaves the remainder of the problem to Congress:

> In all Cases affecting Ambassadors, other public Ministers and Consuls, and *those in which a State shall be Party, the supreme Court shall have original Jurisdiction.* In all the other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make. [Emphasis added].

The appellate jurisdiction is obviously to be over cases in which Congress has given the original jurisdiction to inferior courts established under Section 1, Article III. The question of concern here is whether Congress can also give these inferior courts original jurisdiction over cases in which Article III has given the Supreme Court original jurisdiction. The well-established answer is that Congress can give inferior courts such concurrent jurisdiction, even in cases involving States.

In 1884, the Supreme Court twice addressed itself to the problem of whether Article III's grant of orig-

inal jurisdiction to the Supreme Court was a grant of exclusive jurisdiction. In *Börs* v. *Preston*, 111 U.S. 252 (1884), a consul was a party, and in *Ames* v. *Kansas*, 111 U.S. 449 (1884), a State was a party. In both cases, the Court carefully considered the earlier cases bearing on the point, 111 U.S. at 256-261, 462-471, and laid great stress on the fact that the first Congress, in the Judiciary Act of September 24, 1789, 1 Stat. 73, 80-81, stated that the Supreme Court had exclusive jurisdiction in some cases involving ambassadors and States, and original but not exclusive jurisdiction of other suits involving ambassadors and States. 111 U.S. at 256-257, 463-465. The construction placed on the Constitution by the members of this first Congress was entitled to great weight because many of them had been members of the Constitutional Convention and "were, therefore, conversant with the purposes of its framers." 111 U.S. at 256. Mr. Chief Justice Waite summed up the conclusions of the Court in *Ames* v. *Kansas*, 111 U.S. at 469, in the following language:

> In view of the practical construction put on this provision of the Constitution by Congress at the very moment of the organization of the government, and of the significant fact that from 1789 until now no court of the United States has ever in its actual adjudications determined to the contrary, we are unable to say that it is not within the power of Congress to grant to the inferior courts of the United States jurisdiction in cases where the Supreme Court has been vested by the Constitution with original jurisdiction. It rests with the legislative de-

> partment of the government to say to what extent such grants shall be made, and it may safely be assumed that nothing will ever be done to encroach upon the high privileges of those for whose protection the constitutional provision was intended. At any rate, we are unwilling to say that the power to make the grant does not exist.

The district court chose to brush this passage aside as dictum (R. 30),[4] but that the Supreme Court itself has not so regarded it is plain from the Court's own reliance on it in *United States* v. *Louisiana*, 123 U.S. 32, 36 (1887); *United States* v. *California*, 297 U.S. 175, 187 (1936); *Georgia* v. *Pennsylvania R. Co.*, 324 U.S. 439, 464 (1945); and *Case* v. *Bowles*, 327 U.S. 92, 97 (1946). In *United States* v. *California* and *Case* v. *Bowles*, the Court held that Congress can confer on the district courts of the United States concurrent jurisdiction not only over a suit *between* the United States and a State, but also over a suit *by* the United States *against* a State. The question thus becomes one of whether Congress has done so.

The United States in the present case relies on the jurisdiction given district courts by 28 U.S.C. sec. 1345, entitled "United States as plaintiff," which reads as follows:

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[4] It is not in the least bit clear to us why the presence of a federal question in *Ames* v. *Kansas* makes the Chief Justice's nine-page discussion of exclusive and concurrent jurisdiction dictum, especially when part of that discussion is devoted to a definition of "dicta." 111 U.S. at 467. In any event, "dictum" or not, we submit that Chief Justice Waite was right, as the 80 years of history since then have shown.

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

The section by its terms embraces the case at bar unless it comes within an exception "otherwise provided by Act of Congress." Prior to the 1948 revision of the Judicial Code, 28 U.S.C. sec. 341 (1946 ed.) did otherwise provide in that it gave the Supreme Court "exclusive jurisdiction of all controversies of a civil nature where a State is a party, except between a State and its citizens, or between a State and citizens of other States, or aliens, in which latter cases it shall have original, but not exclusive, jurisdiction." The Act of June 25, 1948, 62 Stat. 869, 927, which completely recodified the Judicial Code, revised the original jurisdiction of the Supreme Court by placing the following provision in 28 U.S.C. sec. 1251(b):

> (b) The Supreme Court shall have original but not exclusive jurisdiction of:
>
> * * * *
>
> (2) All controversies between the United States and a State;
>
> * * * *

Thus, since it is no longer "otherwise provided" by Congress that the Supreme Court have exclusive jurisdiction over controversies between the United States

and a State, Section 1345 grants jurisdiction over such a suit.[5]

Since the revision of Section 1251, both this Court and the Tenth Circuit have in effect held that 1251 (b) (2) makes possible a suit against a State under 1345. In *United States* v. *State of Washington*, 233 F.2d 811 (C.A. 9, 1956), Washington denied that the district court had had jurisdiction over the suit under Section 1345 on the ground that it could not be sued in any forum other than the Supreme Court without its consent. Judge Mathes, sitting on this Court for that case, answered that argument as follows (233 F.2d at 813-814):

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[5] Hart and Wechsler, in *The Federal Courts and the Federal System* (1953), p. 228, state:

> The Revisers' Notes to § 1251 indicate that they were changing the law without knowing what they were doing. Contrary to the revisers' statement, the Supreme Court's jurisdiction of actions by the United States against a state was exclusive under 28 U.S.C. § 341 (1940) * * *.

A comparison of Section 341 of the old code with Section 1251 of the present code will show that there definitely was a change, but there is nothing to indicate the revisers made it without knowing what they were doing. Contrary to Hart and Wechsler's intimation, the revisers did not state that the Supreme Court's jurisdiction of actions by the United States against a State was not exclusive under old Section 341. In fact, the revisers say nothing about the matter or about the precise origin of Section 1251(b) (2). In view of the fact that a special Supreme Court committee, consisting of Chief Justice Stone and Associate Justices Frankfurter and Douglas, assisted the revisers "in the solution of problems of concern to that Court," H.Rept. 308, 80th Cong., 1st Sess., Cong. Doc. Ser. No. 11125, it is hardly likely that the revisers did not know what they were doing.

Since Ames v. Kansas, 1884, 111 U.S. 449, 4 S. Ct. 437, 28 L.Ed. 482, it has been held to be "within the power of congress to grant to the inferior courts of the United States jurisdiction in cases where the supreme court has been vested by the constitution with original jurisdiction." 111 U.S. at page 469, 4 S. Ct. at page 447; see: Case v. Bowles, 1946, 327 U.S. 92, 66 S.Ct. 438, 90 L. Ed. 552; State of New York v. United States, 1946, 326 U.S. 572, 66 S.Ct. 310, 90 L.Ed. 326; United States v. State of Montana, 9 Cir., 134 F.2d 194, 196, certiorari denied, 1943, 319 U.S. 772, 63 S.Ct. 1438, 87 L.Ed. 1720; Hart and Wechsler, The Federal Courts and The Federal System 228 (1953).

Section 1251(b) (2) of revised Title 28 of the United States Code provides that: "The Supreme Court shall have original but not exclusive jurisdiction of: * * * All controversies between the United States and a State * * *."

And 28 U.S.C. § 1345 declares that: "Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States * * *."

The suit at bar to quiet title in the Government in trust for certain Indian wards is clearly an action "commenced by the United States" within the meaning of § 1345. Cf. United States v. Minnesota, 1926, 270 U.S. 181, 46 S.Ct. 298, 70 L.Ed. 539. Accordingly the District Court correctly assumed jurisdiction over the person of the State of Washington. United States v. California, 1936, 297 U.S. 175, 187-189, 56 S.Ct. 421, 80 L.Ed. 567.

Judge Mathes, sitting as the district court in this case, now distinguishes his own holding on the ground that the *State of Washington* case involved the protection of federal real property (R. 33). It is evident from the above passage that this was not the basis of his holding, even if it could be said that the present case did not involve the protection of federal interests in real property.

In *State of Colorado* v. *United States*, 219 F.2d 474, 476-477 (C.A. 10, 1954), the court set forth the following argument and answer:

> Colorado contends further that as a sovereign state it is not subject to the jurisdiction of the Federal District Court. 28 U.S.C.A. § 1251 gives the Supreme Court original but not exclusive jurisdiction of "All controversies between the United States and a State;" and 28 U.S.C.A. § 1345 gives the United States Courts jurisdiction "of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress," and 28 U.S.C.A. § 1355 gives Federal District Courts original jurisdiction exclusive of the courts of the states of actions to enforce fines or penalties incurred under any act of Congress. This was such an action and was instituted under Sections 1345 and 1355, supra.

In addition to these opinions by courts of appeals, there is a holding by a three-judge district court that it had jurisdiction under Section 1345 over a suit by the United States against Louisiana. *Bush* v. *Orleans Parish School Board*, 188 F.Supp. 916, 921 (E.D. La.

1960), affirmed as to other matters, 365 U.S. 569 (1961). And in *United States* v. *State of Wyoming*, 195 F.Supp. 692, 693 (D. Wyo. 1961), aff'd, 310 F.2d 566 (C.A. 10, 1962), certiorari pending, and *United States* v. *State of Minnesota*, 113 F.Supp. 488, 490 (D. Minn. 1953), the district courts stated that they had jurisdiction under 1345 and went on to the merits without further discussion. Cases in which the courts simply took jurisdiction without bothering to state the basis are *Utah State Bd. for Vocational Ed.* v. *United States*, 287 F.2d 713 (C.A. 10, 1961); *State of Utah* v. *United States*, 304 F.2d 23 (C.A. 10, 1962), cert. den., 371 U.S. 826; and *United States* v. *State of California*, 143 F.Supp. 957 (N.D. Cal. 1956).

Despite the unambiguous wording of Sections 1251 and 1345, the district court apparently thinks that Section 1345 must specifically say that it allows suits by the United States against States before such suits can be brought in the district court. The use of the phrases "*all* controversies" in Section 1251 and "*all* civil actions, suits or proceedings" in Section 1345 was not enough to convince the district court that Congress really meant "all," as is apparent from this paragraph of the district court's holding (R. 36-37):

> There is no mention in the language of § 1345 of a State as a party defendant, while § 1251 (b) merely describes in general terms the non-exclusive nature of the Supreme Court's jurisdiction. So there is nothing in the language of these provisions to compel the inclusion of a State as involuntary defendant within the original jurisdiction of the Federal district courts, in an

> action brought by the United States upon a claim for damages caused by alleged tortious conduct of agents of the State.

Earlier in the opinion (R. 28), Judge Mathes pointed to a line of cases "wherein the Congress has, by grant within the ambit of Constitutional power, *specifically conferred* concurrent jurisdiction upon the Federal district courts" [emphasis added]. In connection with the insistence that Section 1345 specify that States can be sued under its authority, it is highly instructive to look at the statutes involved in this group of cases to see just how Congress "specifically conferred concurrent jurisdiction upon the Federal district courts." Once again, a simple listing of the cases and the statutes involved will suffice to make the point:

> *Case* v. *Bowles*, 327 U.S. 92 (1946), was a suit by the Price Administrator against the Commissioner of Public Lands of the State of Washington, but was in effect a controversy between the United States and the State of Washington, 327 U.S. at 97. Jurisdiction was sustained under Section 205(c) of the Price Control Act, Jan. 30, 1942, 56 Stat. 23, 33, as amended, 50 U.S.C. (1940 ed.) Supp. V, app. sec. 925(c), which provided in part: "The district courts shall have jurisdiction of criminal proceedings for violations of section 4 of this Act, and, concurrently with State and Territorial courts, of all other proceedings under section 205 of this Act." The Section does not refer to the possibility that States may be defendants.
>
> *United States* v. *California*, 297 U.S. 175 (1936), was brought under the federal Safety Appliance

Act of March 2, 1893, 27 Stat. 531, 532, as amended, 45 U.S.C. (1934 ed.) sec. 6, which then provided in part: "Any common carrier [violating this Act] shall be liable to a penalty * * * to be recovered in a suit or suits to be brought by the United States district attorney in the district court of the United States having jurisdiction in the locality where such violation shall have been committed * * *." Once again, suits against States are not mentioned.

State of Alabama v. *United States*, 304 F.2d 583 (C.A. 5, 1962), was brought under the Civil Rights Act of 1957, Sept. 9, 1957, 71 Stat. 637, 42 U.S.C. sec. 1971(c),, but had been dismissed because that Act did not authorize the suit against the State. 267 F.2d 808. While the case was pending in the Supreme Court, Congress passed the Civil Rights Act of 1960, May 6, 1960, 74 Stat. 86, 92, 42 U.S.C. (1958 ed.) Supp. III, sec. 1971(c), expressly authorizing such actions against States. The Supreme Court then remanded the case to the district court. 362 U.S. 602 (1960).

United States v. *State of Montana*, 134 F.2d 194 (C.A. 9, 1943), cert. den., 319 U.S. 772, was said to be brought under Section 203(a) of the National Industrial Recovery Act, June 16, 1933, 48 Stat. 202, 40 U.S.C. (1940 ed.) sec. 403. But that section only authorized the acquisition of "any" real property. Jurisdiction of the district court over the condemnation must have rested on the general condemnation provision, 40 U.S.C. (1940 ed.) sec. 257, which again makes no specific mention of States as defendants.

State of Minnesota v. *United States*, 125 F.2d 636 (C.A. 8, 1942), was brought under the gen-

eral condemnation provision, 40 U.S.C. (1940 ed.) sec. 257.

State of California v. *United States*, 91 F.Supp. 722 (N.D. Cal. 1950), was brought by the State against the United States under the Federal Tort Claims Act, 28 U.S.C. secs. 1346 (b, c), 2671-2680. The court held that under 28 U.S.C. sec. 1346(c), which gives the district court "jurisdiction of any set-off, counterclaim, or other claim or demand whatever on the part of the United States against any plaintiff," the United States could file a cross-complaint, here also there being no specific mention of States.

When we note that in five of the six cases cited jurisdiction was based on statutes which made no reference whatsoever to States as defendants, we see that there is no justification for the district court's notion that jurisdiction over States cannot exist unless a statute provides it *in haec verba*. The cases summarized above themselves demonstrate that this is not so.

This Court recently considered a problem analogous to that of the "specifically conferred concurrent jurisdiction" statutes in *United States* v. *Washington Toll Bridge Authority*, 307 F.2d 330, 336 (1962), certiorari ~~pending~~ den. 2-18-63. There this Court rejected the argument that the word "person," as used in 26 U.S.C. sec. 4291, could not be construed to include States, pointing out that States had been considered persons under comparable statutes and citing *Sims* v. *United States*, 359 U.S. 108 (1959). In *Sims*, the Supreme Court met the same argument about 26 U.S.C. sec. 6332: "Though the definition of 'person' in § 6332 does not mention States or any sovereign or political

entity or their officers among those it 'includes' (Note 3), it is equally clear that it does not *exclude* them." 359 U.S. at 112, emphasis by the Court. This can hardly be said to be giving "a restrictive meaning" to a statute in the presence of "serious Constitutional doubts," the district court's reason for refusing to admit that Sections 1251(b) and 1345 say what they say (R. 36, 37).

The unambiguous wording of Sections 1251 and 1345, the construction placed upon these provisions by this Court and others, and the frequent assumption of jurisdiction under them all make clear that the lower court erred in dismissing the Government's suit.[6] The judicial power of the United States does embrace the suit and Congress has given the district court jurisdiction over it.

III

State Immunity To Suit By Individuals In Its Own Courts Has No Bearing On Federal Jurisdiction and Is No Bar To Suits By the United States

The Constitution establishes the judicial power of the United States, and the Constitution and the Judicial Code, Title 28, U.S.C., give the various federal courts jurisdiction to exercise that judicial power. If federal jurisdiction exists in a given case, it cannot be modified by state law, either statutory or case law. In *Harrison* v. *St. L. & San Francisco R.R.*, 232 U.S.

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[6] So far as we know, this case stands alone in denying jurisdiction.

318, 328 (1914), the Court, upholding the right of removal from a state to a federal court, said:

> It may not be doubted that the judicial power of the United States as created by the Constitution and provided for by Congress pursuant to its constitutional authority, is a power wholly independent of state action and which therefore the several States may not by any exertion of authority in any form, directly or indirectly, destroy, abridge, limit or render inefficacious. The doctrine is so elementary as to require no citation of authority to sustain it. Indeed, it stands out so plainly as one of the essential and fundamental conceptions upon which our constitutional system rests and the lines which define it are so broad and so obvious that, unlike some of the other powers delegated by the Constitution, where the lines of distinction are less clearly defined, the attempts to transgress or forget them have been so infrequent as to call for few occasions for their statement and application. * * *

In *Cowles* v. *Mercer County,* 7 Wall. 118, 122 (1868), Chief Justice Chase had said that "no statute limitation of suability can defeat a jurisdiction given by the Constitution." To the same effect are *Hyde* v. *Stone,* 20 How. 170, 175 (1857); *Insurance Company* v. *Morse,* 20 Wall 445, 453 (1874); *Lincoln County* v. *Luning,* 133 U.S. 529, 531 (1890); *Chicot County* v. *Sherwood,* 148 U.S. 529, 534 (1893); *Smyth* v. *Ames,* 169 U.S. 466, 516-517 (1898); and *Barrow Steamship Company* v. *Kane,* 170 U.S. 100, 111 (1898). Thus it is plain that whatever rule California follows as to its own immunity to suit is irrele-

vant where, as here, jurisdiction rests on the Constitution and the Judicial Code.[7]

It follows logically from the foregoing that any California immunity to private suit in its own courts is not effective in the federal courts because their jurisdiction is independent of state law. That is, any state immunity to private suits in the federal courts must stem from federal, not from state law. *Chisholm* v. *Georgia*, 2 Dall. 419 (1793), took an extreme view on lack of necessity for state consent to suit in the federal courts, holding that Article III extended the judicial power of the United States to unconsented suits against a State by citizens of another State. This prompted the adoption of the Eleventh Amendment, which reads as follows: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of an-

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[7] The district court's opinion states that California asserted sovereign immunity at the hearing (R. 23), but the minutes do not indicate that the State said anything (R. 15). The State has yet to file a pleading or brief in this case. The status of the doctrine of sovereign immunity in California at the time of the district court's dismissal of this case was hardly as clear as the district court indicated. In *Muskopf* v. *Corning Hospital District*, 55 Cal.2d 211, 11 Cal. Rptr. 89, 359 P.2d 457 (1961), the Supreme Court abolished the doctrine. On September 15, 1961, the California legislature reinstated the doctrine until 90 days after the 1963 Regular Session of the Legislature, Cal.Stats. 1961, C. 1404, p. 3209, Cal. Civil Code, sec. 22.3. That this statute merely suspends actions against the State is the gist of *Corning Hospital Dist.* v. *Superior Court of Tehama Co.*, 57 Cal.2d 488, 20 Cal. Rptr. 621, 370 P.2d 325 (1962).

other State, or by Citizens or Subjects of any Foreign State." But in stating the extent of a State's immunity to private suits in federal courts, the Eleventh Amendment gives no sanction to the notion that a State has sovereign immunity against suits by the United States, a notion long since dispelled by the Supreme Court.

In *United States* v. *Texas*, 143 U.S. 621 (1892), Texas argued that it could be sued by the United States only in its own courts with its consent. Repeating the rule that "it is inherent in the nature of sovereignty not to be amenable to the suit of an *individual* without its consent" (143 U.S. at 645-646, emphasis by Court), the Court pointed out that a suit between sovereigns was a different matter (143 U.S. at 646):

> The question as to the suability of one government by another government rests upon wholly different grounds. Texas is not called to the bar of this court at the suit of an individual, but at the suit of the government established for the common and equal benefit of the people of all the States. The submission to judicial solution of controversies arising between these two governments, "each sovereign, with respect to the objects committed to it, and neither sovereign with respect to the objects committed to the other," *McCulloch* v. *State of Maryland*, 4 Wheat. 316, 400, 410, but both subject to the supreme law of the land, does no violence to the inherent nature of sovereignty. The States of the Union have agreed, in the Constitution, that the judicial power of the United States shall extend to *all* cases arising under the

> Constitution, laws and treaties of the United States, without regard to the character of the parties, (excluding, of course, suits against a State by its own citizens or by citizens of other States, or by citizens or subjects of foreign States,) and equally to controversies to which the United States shall be a party, without regard to the subject of such controversies, and that this court may exercise original jurisdiction in all such cases, "in which a State shall be party," without excluding those in which the United States may be the opposite party. The exercise, therefore, by this court, of such original jurisdiction in a suit brought by one State against another to determine the boundary line between them, or in a suit brought by the United States against a State to determine the boundary between a Territory of the United States and that State, so far from infringing, in either case, upon the sovereignty, is with the consent of the State sued. Such consent was given by Texas when admitted into the Union upon an equal footing in all respects with the other states.

In *Monaco* v. *Mississippi*, 292 U.S. 313 (1934), the Supreme Court considered carefully and at length the problem of when a State's consent is necessary for suits to be entertained against her under Article III as construed in the light of the Eleventh Amendment. While the Court would not hold that the inclusion of certain cases in Article III automatically dispensed with the necessity of state consent,[8] it said that there

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[8] The opinion views *Chisholm* v. *Georgia, supra,* as departing from the understanding of the Constitution's fathers

were others in which consent could be implied as inherent in the constitutional scheme. In this category went suits against States by other States and by the United States, about which the Court said the following (292 U.S. at 328-329):

> 1. The establishment of a permanent tribunal with adequate authority to determine controversies between the States, in place of an inadequate scheme of arbitration, was essential to the peace of the Union. The Federalist, No. 80; Story on the Constitution, § 1679. With respect to such controversies, the States by the adoption of the Constitution, acting "in their highest sovereign capacity, in the convention of the people," waived their exemption from judicial power. The jurisdiction of this Court over the parties in such cases was thus established "by their own consent and delegated authority" as a necessary feature of the formation of a more perfect Union. *Rhode Island* v. *Massachusetts*, 12 Pet. 657, 720; *Louisiana* v. *Texas*, 176 U.S. 1, 16, 17; *Missouri* v. *Illinois*, 180 U.S. 208, 240; *Kansas* v. *Colorado*, 185 U.S. 125, 142, 144; 206 U.S. 46, 83, 85; *Virginia* v. *West Virginia*, 246 U.S. 565.
>
> 2. Upon a similar basis rests the jurisdiction of this Court of a suit by the United States against a State, albeit without the consent of the latter. While that jurisdiction is not conferred by the Constitution in express words, it is inherent in the constitutional plan. *United States* v. *North Carolina*, 136 U.S. 211; *United States*

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that suit against a State would be only by its consent, and the Eleventh Amendment as restoring this understanding. 292 U.S. at 324-325, 329.

v. *Texas*, 143 U.S. 621, 644, 645; 162 U.S. 1, 90; *United States* v. *Michigan*, 190 U.S. 379, 396; *Oklahoma* v. *Texas*, 258 U.S. 574, 581; *United States* v. *Minnesota*, 270 U.S. 181, 195. Without such a provision, as this Court said in *United States* v. *Texas*, *supra*, "the permanence of the Union might be endangered."

United States v. *California*, 297 U.S. 175 (1936), further demonstrates the irrelevance of the State's sovereign immunity, especially of the distinction between sovereign or governmental functions and proprietary functions (see R. 16-17, pars. 2, 3; R. 23-24). In that case, California claimed that it was not subject to the Federal Safety Appliance Act because it operated the railroad in question in its sovereign capacity. The Court dismissed the contention in the following passage (297 U.S. 183-184):

> Despite reliance upon the point both by the government and the state, we think it unimportant to say whether the state conducts its railroad in its "sovereign" or in its "private" capacity. That in operating its railroad it is acting within a power reserved to the states cannot be doubted. * * * The only question we need consider is whether the exercise of that power, in whatever capacity, must be in subordination to the power to regulate interstate commerce, which has been granted specifically to the national government. *The sovereign power of the states is necessarily diminished to the extent of the grants of power to the federal government in the Constitution.* * * * [Emphasis added.]

Similarly, that building a road may be a governmental function under California law does not immunize the State to suit by the United States for the destruction of public property. Such immunity would infringe the plenary power of Congress, granted it in Clause 2, Section 3, Article IV of the Constitution, "to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States * * *." As to the authority of the Attorney General to bring the suit to vindicate the federal interest, see *United States* v. *San Jacinto Tin Co.*, 125 U.S. 273, 278-285 (1888); *United States* v. *California*, 332 U.S. 19, 26-29 (1947).

To avoid belaboring the point further, we will simply refer the court to the many cases cited in Points I and II in which the United States successfully sued States. State immunity to private suit is no more a barrier to suit by the United States in the present case than it was in any of those.

CONCLUSION

For the foregoing reasons, we submit that the judgment of the district court should be reversed and the case remanded for appropriate pleading by the State and trial on the merits.

Respectfully,

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February 1963.

CERTIFICATE OF EXAMINATION OF RULES

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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No. 18249

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HAMMERMILL PAPER CO., a corporation, substituted for COAST ENVELOPE COMPANY, doing business as COAST BOOK COVER CO.,

Plaintiff-Appellant,

vs.

THE ARDES COMPANY, a corporation,

Defendant-Appellee.

PETITION FOR REHEARING.

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vs.

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Defendant-Appellee.

PETITION FOR REHEARING.

Appellant respectfully petitions for a rehearing of this case, which was decided on June 25, 1963. The grounds upon which the petition is based are that:

1. The Court has invalidated the highly successful, although limited, Miller patent in suit, which has been respected by the entire industry for over thirteen years, by accepting the *admittedly speculative* conclusions of appellee's biased expert as to the disclosure of the prior Rockwell patent [Ex. A-2], in lieu of drawing its own conclusions from the patent itself, which is simple and certainly required no expert explanation.

> *National Sponge Cushion Co. v. Rubber Corp. of Calif.*, 286 F. 2d 731, Ninth Circuit.
>
> "A patent relied upon as an anticipation must itself speak and its specification must give in substance the same knowledge and same directions as the specification of the patent in suit."
>
> *Cold Metal Process Co. v. Carnegie-Illinois Steel Corp.*, 108 F. 2d 322, 333, Third Circuit;
>
> *Walker, Deller's Edition,* page 270.

2. This Court's ruling constitutes a precedent which, if allowed to stand, seriously endangers the future of our patent system, since it sanctions acceptance of admittedly speculative conclusions of an adverse expert as to the disclosure of an alleged anticipatory patent, despite the fact that the conclusions are not borne out by the disclosure of the patent document itself.

ARGUMENT.

The Court's opinion states:

> "Defendant's expert witness testified that the right hand edge of the 'clip' in the Rockwell patent is tapered, and 'that tapered portion continues down to the terminating edge which is disposed vertically relative to the base portion'."

However, this Court apparently failed to note that appellee's expert did not make that statement as a positive fact, but admitted that the Rockwell patent disclosure was of such small scale as to cause him to "wonder" as to what it did show. For instance, when he was asked on cross-examination [R. 147-148] to point out where the Rockwell patent drawing showed a downwardly disposed edge intersecting the side in a taper, he admitted:

> "Well, I wondered about that. I think there may be a suggestion of a taper on the right hand end. Of course the scale of that drawing is rather small and the amount of that—the extent of the lip is really quite short in comparison with the thickness of a line and I admit it is hard to determine from the drawing of Figure 1 whether there is a taper there—whether the taper is actually shown."

Moreover, the Rockwell patent drawing actually shows the side edge of the wall designated as 23 as being the only part which is tapered and cut away, to provide the upturned flange designated as 26. The

wall 23 of the Rockwell patent, in the nomenclature of its specification, is called the front wall or flange merely because the Rockwell patent specification describes the clip as it would appear in a vertical position, that is, with its base portion considered in vertical as distinguished from horizontal position. On the other hand, in the nomenclature used in the Miller patent in suit, appellant's clip is described as it would appear when considered in horizontal position. The wall designated as 24 in the Rockwell patent is therefore actually the *front* wall if interpreted in accordance with the nomenclature of the Miller patent.

This Rockwell patent was not discussed in particular detail at the hearing of this appeal simply because the defendant was there relying principally upon the British patent to Bonnet, No. 17932 [Ex. A-1] as being anticipatory. As pointed out in Appellant's Opening Brief herein, the appellee tried and abandoned the Bonnet structure prior to adopting the accused structure.

The Rockwell patent specification (p. 1, column 2, lines 59-67) states:

> "The lower edge of this front flange (23) is bent back as at 24 to form the double function of holding the pad in conjunction with the picket-edge 17, as presently will be described, and of forming a *cutting edge* for the leaves of the pad. At one side 25 the front flange is cut away and is curved outward as at 26."

There it will be noted that only the wall 23, which is the top wall, is described as being cut away. The vertically disposed wall 24 is nowhere described or shown as being cut away or beveled.

A clear illustration of the disclosure of the Rockwell patent is found in the fully authenticated [R. 194] physical model [Ex. 17].

In any event, by reference to Fig. 1 of the Rockwell patent (which is a perspective view showing the Rockwell device as viewed from the left front), it will be seen that the downwardly disposed or vertical wall 24 is defined by two *parallel* lines, which certainly would not indicate any bevel or curve.

Obviously, what appellee's expert has done is to do a bit of wishful thinking. With full knowledge of the teachings of the successful Miller patent in mind, he has tried to use that knowledge in reconstructing the Rockwell patent disclosure to verbally change it into an anticipating structure when, in fact, it is not.

Wherefore, appellant respectfully submits that, in the interests of justice, this petition should be granted.

Dated: July 24, 1963

COLLINS MASON and
A. DONHAM OWEN,
By COLLINS MASON,
Attorneys for Appellant.

Certificate of Counsel.

I, Collins Mason, counsel for Petitioner in the above entitled action, hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay, and in my opinion is well founded in law and in fact, and proper to be filed herein.

COLLINS MASON,
Attorney for Petitioner.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

COLLINS MASON,

In the United States Court of Appeals for the Ninth Circuit

No. 18252

THE SUPERIOR OIL COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL POWER COMMISSION

BRIEF FOR THE FEDERAL POWER COMMISSION

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INDEX

677819—63——1

TABLE OF CITATIONS

Cases—Continued

Cases—Continued

Cases—Continued

Statutes and Regulations:

Statutes and Regulations—Continued

Miscellaneous:

In the United States Court of Appeals for the Ninth Circuit

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BRIEF FOR THE FEDERAL POWER COMMISSION

STATEMENT OF JURISDICTION

This is a proceeding to review an order of the Federal Power Commission issued on June 15, 1962 (R. 120), reported at 27 FPC 1266. Petitioner's application for rehearing (R. 123–131), filed on July 9, 1962, was denied on August 8, 1962, by the Commission's non-action within 30 days. Section 19(a) of the Natural Gas Act, 15 U.S.C. 717r(a)[1]; F.P.C., Rules of Practice and Procedure, Section 1.34, 18 C.F.R. 1.34. The petition for review was filed on October 5, 1962. Jurisdiction of this Court rests upon Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).[2]

STATEMENT OF THE CASE

Petitioner, an independent producer of natural gas, seeks review of an order (R. 120) rejecting an application for a certificate of public convenience and necessity and the related proposed rate schedule, which were based on a contract containing certain price-changing provisions other than those allowed by Section 154.93 of the Commission's regulations. The basic question involved is whether the Commission's regulations limiting the types of price-changing provisions permissible in producer contracts constitute a reasonable exercise of the Commission's rule-making authority.

The Commission's regulations under the Gas Act, Section 154.91, *et seq.*, provide that independent producers who

[1] Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821–833, as amended, 15 U.S.C. 717–717w. For the convenience of the Court pamphlet copies of the Act, as well as pamphlet copies of the Commission's "Rules of Practice and Procedure" and "Regulations under the Natural Gas Act," will be lodged with the Clerk prior to argument.

[2] Superior seems to base its jurisdictional claim on Section 10 of the Administrative Procedure Act as well as Section 19(b) of the Gas Act (Pet. Br. p. 1). It is clear, however, that Section 10 of the Administrative Procedure Act, 5 U.S.C. 1009, does not grant a right of review not given by the Natural Gas Act. *F.P.C.* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 500; *Wisconsin* v. *F.P.C.*, 292 F. 2d 753 (CADC); *Magnolia Petroleum Co.* v. *F.P.C.*, 236 F. 2d 785, 793 (CA 5), certiorari denied, 352 U.S. 968; *Amerada Petroleum Corp.* v. *F.P.C.*, 231 F. 2d 461, 465 (CA 10).

are natural gas companies subject to the Commission's jurisdiction under the Gas Act shall file their contracts as their rate schedules, and Section 154.93 provides in part:

> * * * That in contracts executed on or after April 3, 1961, for the sale or transportation of natural gas subject to the jurisdiction of the Commission, any provision for a change of price other than the following provisions shall be inoperative and of no effect at law; the permissible provisions for a change in price are:
>
> (a) Provisions that change a price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller;
>
> (b) Provisions that change a price to a specific amount at a definite date; and
>
> (c) Provisions that, once in five-year contract periods during which there is no provision for a change in price to a specific amount (paragraph (b) of this section), change a price at a definite date by a price-redetermination based upon and not higher than a producer rate or producer rates which are subject to the jurisdiction of the Commission, are not in issue in suspension or certificate proceedings, and, are in the area of the price in question * * *.[3]

That section of the regulations also provides that "any contract executed on or after April 2, 1962, containing price-changing provisions other than the permissible provisions" described above "shall be rejected." Section 157.25 of the regulations similarly provides that an independent producer application for a certificate of public convenience and necessity "shall be rejected" if any contract submitted in support thereof contains non-permissible price-changing provisions, and Section 157.14(a)(10)(v) provides that any producer contract executed after April 2, 1962, containing any non-permissible price-changing clauses "will be given no consideration in de-

[3] The quoted language was added to the regulations by Order No. 232, issued March 3, 1961, (App. A, *infra*, pp. 49–54, 25 FPC 379, 26 Fed. Reg. 1983), as amended by Order No. 232A., issued March 31, 1961 (Pet. Br. App. C, pp. 17a–20a, 25 FPC 609, 26 Fed. Reg. 2850).

termining adequacy" of a pipeline company's gas supply showing in support of a certificate application. These provisions were added to the regulations by Order No. 242, issued February 8, 1962 (Pet. Br. App. B., pp. 13a–16, 27 FPC 339, 27 Fed. Reg. 1356).

Procedural history of the regulations.—Orders No. 232 and 232A, which amended Section 154.93 by limiting the types of price-changing provisions that would be permissible in producer contracts executed after the effective date of those orders, were issued in a rule-making proceeding initiated by a notice of proposed rule-making published in the Federal Register on April 12, 1956 (21 Fed. Reg. 2388) and by mailing notices to interested parties, including state and federal regulatory agencies (App. A, *infra,* p. 49, 25 FPC at 380). In that notice (21 Fed. Reg. 2388), the Commission stated that it proposed to amend its regulations relating to independent producers to describe certain types of contracts for the sale of natural gas which would not be accepted for filing as rate schedules. Its specific proposal was that the Commission would not accept for filing contracts containing provisions calling for price adjustments based on "(a) escalation clauses based on price indices or changes in the price received by the purchaser upon resale, or (b) the payment or offer of payment of higher prices by the purchaser or other purchasers in the same or other producing areas to the same or other sellers" (21 Fed. Reg. 2389).

The Commission, in its notice, invited comments on or before June 1, 1956, and stated that it would not act prior to that date (21 Fed. Reg. 2389). Numerous responses were received by the Commission, both in support of the proposed rule and in opposition, including a protest from the petitioner (See App. B, *infra,* pp. 55–59). Thereafter, the Commission in *Pure Oil Co.,* 25 FPC 383, affirmed, 299 F. 2d 370 (CA7), received the benefit of extensive hearings, briefs and oral arguments on the issue of whether or not favored-nation clauses are contrary to public policy.[4]

[4] While that case was decided on the ground that the favored-nation clause had not been triggered, the Commission, as stated in Order No. 232, explained there why it regarded indefinite escalation clauses to be contrary to the public interest. *Pure Oil Co.,* 25 FPC 383, 387–391.

The rule making proceeding resulted in the issuance on March 3, 1961, of Order No. 232 (App. A, *infra,* pp. 49–54, 25 FPC 379). In that order the Commission found that long-term gas supply contracts containing indefinite escalation clauses, which it defined as all price escalation provisions other than those calling for increases of specific amounts at definite dates or those intended to reimburse the seller for all or any part of changes in production, severance or gathering taxes levied on the seller, "* * * have contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies," and that these clauses are contrary to the public interest as found in *Pure Oil Co.,* 25 FPC 383. For these reasons, the Commission amended its regulations to prohibit the use of indefinite escalation provisions in new producer contracts. It did so by adding definitions of "definite" and "indefinite" escalation clauses to Section 154.91 of its regulations and by adding a proviso to Section 154.93 of its regulations declaring that any provision for a change of price based on an indefinite escalation clause in a contract filed on or after April 3, 1961, would be "inoperative and of no effect at law", *infra,* App. A, p. 51, 25 FPC at 381. Order 232 also provided that the amendments to the regulations there promulgated would become effective April 3, 1961. The order provided further that any interested person could submit written views or comments to the Commission by March 20, 1961. *Ibid.*

On March 31, 1961, the Commission, upon consideration of many comments filed by interested persons (none were filed by the present petitioner), issued Order 232A to modify the amendments to the regulations promulgated by Order 232. In this order, the Commission found that it "appears that elimination of all indefinite escalation provisions would be too restrictive to enable the industry adequately to cope with possible changing economic conditions over the span of long-term contracts. Therefore, to permit pricing flexibility and to provide an incentive for long-term contracts, we should permit future contracts to contain limited price-redetermination provisions, invocable not more than once in every five-year contract period and based upon rates subject to this Commission's

jurisdiction (and therefore, controlled)". Pet. Br., App. C, pp. 17a–18a, 25 FPC 609–610. It also concluded that the amendment to the regulations should apply only to contracts "executed" on or after April 3, 1961 (under Order 232 the amendment would have applied to contracts "filed" on or after that date, whenever executed).[5]

Order 242, which spelled out the procedures to be used in effectuating the amended provisions of Section 154.93 of the regulations promulgated by Order 232A, was also issued as a rule of general applicability.

The rule-making proceeding resulting in Order 242 was initiated by a notice of proposed rule-making published in the Federal Register on October 14, 1961 (26 Fed. Reg. 9732), and by mailing notices to interested persons, including natural gas companies, and to State and Federal agencies (Pet. App. B, p. 13a, 27 FPC 339). In that notice, the Commission noted that in Order No. 232A it had amended Section 154.93 of its Regulations to provide that, with certain exceptions, indefinite price changing provisions in producer contracts executed on or after April 3, 1961, would be inoperative and of no effect at law. It then explained (26 Fed. Reg. 9732):

> Having found in Order No. 232A that indefinite escalation provisions "* * * are generally undesirable, unnecessary and incompatiable with the public interest for the due and proper development of natural gas service by natural gas companies * * *", it appears that no useful purpose can be served by the Commission's acceptance of contracts containing indefinite price escalation provisions or of applications relying upon contracts having such provisions as proof of the applicants' gas supply.

The specific amendments proposed were substantially the same as those eventually adopted in Order No. 242, except that the proposed regulations would have rejected rate schedules or certificate applications *filed* after the specified date, rather than only those *executed* after the specified date as provided by Order No. 242.

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[5] Sun Oil Company's petition to review the Order No. 232 and 232A was dismissed for lack of jurisdiction. *Sun Oil Co.* v. *F.P.C.*, 304 F. 2d 293 (CA5), certiorari denied, 371 U.S. 861.

The Commission, in its notice, invited comments on or before November 13, 1961 (*Ibid.*). Numerous responses were received by the Commission, both in support of the proposed rule and in opposition (Pet. App. B, p. 13a, 27 FPC 339), including comments from the present petitioner. See App. C, *infra,* pp. 60–64. While challenging both the validity and need for the proposed amendment to the regulations, as well as those adopted by Order 232A, petitioner stated that if the Commission concluded in a certificate proceeding that particular price-changing provisions "so vitiated the contract as to make it not in the public interest, the Commission clearly has the power under the Natural Gas Act to deny a Certificate of Public Convenience and necessity to the independent producer." App. C, *infra,* p. 64.

On February 8, 1962, the Commission issued Order No. 242 (Pet. App. B, pp. 13a–16a, 27 FPC 339). While the new order simply spelled out a procedure for implementing the existing regulation, the Commission again explained the basis for the existing regulations, the validity of which had been challenged in many of the comments. The Commission explained, *inter alia,* that it could not acquiesce in the use of contracts which include provisions which prevent effective rate regulation and that the existing regulation and the amendments thereto were necessary or appropriate to correct the impediment to regulation caused by the proscribed indefinite price-changing provisions.[6]

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[6] A number of producers, including the present petitioner (see App. D., *infra*, pp. 65–68), filed applications for rehearing of Order 242. After these were denied on April 4, 1962 (27 FPC 666), six petitions for review of that order were filed. In response to our motions to dismiss on the ground that the order was not reviewable prior to a specific application, the Fifth Circuit dismissed the petitions of Hunt Oil Company, Humble Oil Refining Company and petitioner (*Hunt Oil Co.* v. *F.P.C.*, 306 F. 2d 878 (CA5)) and the Third Circuit dismissed Shell Oil Company's petition. *Shell Oil Co.* v. *F.P.C.*, CA3, No. 14058, decided July 17, 1962 (not reported). The motions to dismiss the petitions of Pan American Petroleum Corporation and Sun Oil Company are still pending in the Tenth Circuit, Nos. 7002 and 7179. That Court, which deferred action on our motions to dismiss until hearing upon the merits, has scheduled arguments on the merits for March 18, 1963.

It may be noted that in addition to the present challenge of these regulations upon an application thereof, two other petitions have been filed as

The order under review.—On the basis of these regulations, the Commission, on June 15, 1962, rejected (1) Superior's application of May 25, 1962, for a certificate of public convenience and necessity authorizing it to sell gas to El Paso Natural Gas Company from previously undedicated acreage in Aneth Field, Utah, pursuant to an agreement of April 9, 1962, containing non-permissible price changing provisions, and (2) the related rate filing (R. 120).

The April 9, 1962, agreement (R. 107–110), which dedicated 2640 acres for the sale of gas to El Paso, incorporated by reference the provisions of a 20-year casinghead gas contract between Superior and El Paso dated June 11, 1958, as thereafter supplemented (R. 11–47, 59–62, 67–70, 78–81, 93–94, 100–101). Nothing in the June 11, 1958, contract, which was in form amended by the April 9, 1962, agreement, required or expressly permitted Superior to add acreage to that originally listed. The pricing terms adopted by the April 9, 1962, agreement called for an initial price of 20¢ per Mcf for the first five years commencing with the date of initial delivery under the original contract, 21¢ per Mcf for the second five-year period, 22¢ per Mcf for the third five-year period, 23¢ for the fourth five-year period, and 24¢ per Mcf thereafter if the contract remained in effect (R. 30–1, 39). (The initial price was reduced to 17.7 cents per Mcf, in accordance with the condition attached to the certificate issued by the Commission for sale under the 1958 contract, R. 100–101). However, in addition to these permissible fixed-price escalation provisions, the provisions of the 1958 contract incorporated into the April 9, 1962, agreement also provided for a price redetermination for each five-year period after the first (R. 31–32) and included a so-called favored-nation clause providing that El Paso would never pay petitioner less than the price it was paying "others for comparable gas delivered under comparable conditions" within a specified area (R. 32).

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a result of other rejections based on those regulations. *Texaco Inc.* v. *F.P.C.*, CA10, No. 7217 (argument set for March 18, 1963; motion to dismiss for lack of proper venue also pending); *Sun Oil Co.* v. *F.P.C.*, CA5, No. 20290, petition for review filed January 28, 1963.

677819—63——2

The price redetermination clause provides specifically (R. 31–32):

> Seller shall have the right, at its option, to request a redetermination of the price provided in Section 7 of this Article to be paid for any one or more or all (but not part) of the periods set out in (b), (c), (d) and (e) above. Any such request made with respect to any of such periods shall be made in writing during the six (6) months immediately preceding the commencement of such period. If Seller shall make any such request, representatives of Buyer and Seller shall promptly meet and attempt to determine the then reasonable market price of the gas deliverable hereunder. In making such determination, consideration shall be given to all pertinent factors. The price so determined by Buyer and Seller shall be the price applicable during the entire period with respect to which the same was determined; provided, that if such price shall be less than the price provided in Section 7 of this Article with respect to such period, the price during such period shall be as provided in Section 7.

The favored-nation clause provides (R. 32):

> Buyer agrees that the price to be paid from time to time to Seller hereunder for Residue Gas shall never be less than the price being paid by Buyer to others for comparable gas delivered under comparable conditions within the area shown on Exhibit "B" attached hereto.

On July 9, 1962, within the statutory 30-day period after the Commission's rejection of petitioner's tendered application for a certificate and proposed rate schedule, petitioner filed its "Application for Reconsideration of Rejected Supplement to Rate Schedule" (R. 123–131). There petitioner complained that the summary rejection of its certificate application and related rate schedule filing was invalid because the regulations on which the Commission relied were invalid, the regulations and the rejection order were improperly issued without opportunity for hearing, and in any event the Commission cannot, even in a rate or certificate proceeding, modify provisions of

contracts which "do not affect the initial 'rate charge or classification'" (R. 126).[7] Petitioner did not contend that its contract did not contain proscribed price-changing provisions and made no request for a waiver of the regulations as to this sale. Since the Commission did not act on petitioner's application for rehearing, it was deemed to have been denied on August 8, 1962 (*supra*, p. 1). The petition for review followed.

SUMMARY OF ARGUMENT

The only real issue presented by this case is the validity of the Commission's regulations limiting the types of price-changing provisions that may be included in producer contracts executed after the regulations were promulgated. For it is clear that if the regulations are valid the Commission was free to reject petitioner's certificate and rate filings which were inconsistent with those regulations. See, *e.g.*, *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192.

I. We show first that the Commission had a reasonable basis for finding and concluding that the challenged regulations are reasonable and necessary or appropriate to permit the effective regulation contemplated by the Natural Gas Act. Petitioner is wrong in saying that these regulations proscribe all provisions for contract flexibility and substantively limit the price that producers many charge. To the contrary, the regulations permit all fixed price escalations, and permit limited redeterminations every five years, and thus allow broad pricing flexibility during the course of long-term contracts, but, unlike the proscribed favored-nation and unlimited price-redetermination provisions in petitioner's contract, do so without frustrating effective rate and certificate regulation by the Commission. A number of considerations show the absence of any justifiable need for the proscribed provisions.

The Commission was fully justified in concluding that those clauses have impeded effective regulation. Thus experience has shown the Commission that they have induced increased rate filings without any individual determination by the filing

[7] As we noted, *supra*, p. 6, in its comments on proposed Order 242, petitioner had flatly asserted the rule was unnecessary since the Commission, could deny a certificate if the contract was not in the public interest.

company as to its needs, solely because under such provisions a contract right to file came into existence. As illustrated, *infra,* pp. 21–25, the proscribed clauses raise many complex questions of contract interpretation and application which have to be resolved by the Commission to determine whether a particular filing based on one of the proscribed provisions was contractually authorized, since the courts have held that contractually unauthorized filings must be rejected by the Commission. This need to resolve such complex contract questions to determine Commission jurisdiction necessarily impairs its ability to determine whether to exercise its suspension power within the 30-day period available, and to fulfill its primary obligation of determining just and reasonable rates "as speedily as possible." Section 4(e) of the Act.

In addition, the increased prices provided for by many of the proscribed clauses, including those in petitioner's contract here, are indeterminate. In such circumstances, the Commission cannot realistically determine whether the rate should be suspended and a hearing initiated to determine its reasonableness because of the uncertainity as to the exact rate.

Furthermore, the proscribed clauses also impede the Commission's obligation to provide effective certificate regulation. Thus, as this Court has held, in producer certificate cases the Commission must give careful scrutiny to proposed producer prices in an attempt to "hold" the price line. That requires a consideration of the full pricing terms of a contract, not just the initial price. If prices can be changed to indeterminate amounts at any time, even the first day after a certificate is to be issued, such a comparison becomes impossible.

Finally, the proscribed price-changing provisions in producer contracts make any showing of the economic feasibility of a pipeline's project very speculative, though the necessity for such a showing in certificate cases has long been recognized. This is so because such a showing depends on evidence of a market to ultimate consumers. But since the size of that market demand will depend to a considerable extent upon the price to be charged for the gas, relative to the cost of competing fuels, the completely indeterminate pricing which would be possible

under the proscribed clauses may preclude any realistic estimates of market demand.

These considerations show that the Commission had a reasonable basis for promulgating the challenged regulations. Thus, this Court should approve the regulations since a court will set aside agency regulations only if no reasonable basis therefor is apparent, even if the court might not have acted in precisely the same way. See, *e.g., American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298, 314.

II. The Commission has clear authority to regulate contract provisions by rules or regulations. Section 16 of the Gas Act specifically empowers the Commission to issue such rules and regulations "as it may find necessary or appropriate to carry out the provisions" of the Act. We do not argue that this authority may be used in a manner inconsistent with the Act, for the regulations here involved are fully consonant with the Act, and, contrary to petitioner's assertions, are predicated upon substantive powers found in specific sections of the Act. We show first the source of the substantive power over contracts and then that the Commission may exercise that power in rulemaking proceedings of general applicability, as well as by *ad hoc* determinations.

Initially, it is apparent that there is no basis for petitioner's contention that the Natural Gas Act precludes the Commission from modifying contracts. Sections 5(a) and 4(e) expressly authorize the Commission to change contracts, as well as rates, in rate proceedings. This clear power has been recognized judicially.

Similarly, Sections 7(a) and 7(e) of the Act authorize the Commission to consider and modify rate structures and contracts in issuing certificates of public convenience and necessity. As we show in detail, *infra,* the Commission's power to modify contracts in certificates proceedings is at least as great as in Sections 4 or 5 rate proceedings. Judicial decisions, as well as the legislative history of Section 7, leave no doubt that rate structures and contract provisions are to be considered prior to the initiation of service, and the Commission has long exercised such authority in certificate proceedings.

While Sections 4, 5 and 7, from which the Commission's substantive power over contracts is derived, provide for hearings before action on individual rate or certificate filings, petitioner's contentions that these procedural provisions curtail the Commission's authority under Section 16 to carry out by general rule the regulation of contracts authorized by these sections is without merit. *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, rejected virtually identical contentions.

III. Petitioner's contentions that the regulations are discriminatory because pipeline companies have not been subjected to the same regulations as producers, ignores the fact that mere difference in treatment of different classes of companies does not invalidate a regulation. Since inception of producer regulation, pipelines and producers have reasonably and necessarily been accorded different treatment by Commission regulations. *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division*, 358 U.S. 103, while holding that the Gas Act did not automatically prohibit inclusion in pipeline service agreements of provisions permitting pipelines to increase their rates at will, did not, contrary to petitioner's claim, indicate that the Commission must tolerate types of escalation provisions destructive of effective regulation.

Petitioner's further claim of discrimination because it had previously received certificate authorization to sell gas from adjacent acreage pursuant to contract terms identical to those now rejected is frivolous. For the Commission is, of course, free to reexamine its earlier decisions and reach different results in the event of changed circumstances. Moreover, petitioner's attempt to treat its new agreement to sell previously uncommitted gas as part of an earlier contract cannot disguise the fact that a contract which voluntarily adopts or incorporates the terms of an earlier contract solely for the convenience of the parties is a new contract as a matter of law.

IV. Finally, the fact that some of the proscribed price-changing provisions have in the past been given effect both by the courts and the Commission before the adoption of the rule in no way limits the Commission's power to adopt the rule. For whether or not a contract clause is valid as a matter of general law, its legality under a supervening regulatory scheme

is a separate question. We also show that the Commission has long indicated its disapproval of the proscribed clauses and that its requests for Congressional proscription of most indefinite escalation clauses in both existing and future producer contracts, which were made as part of a package request for modifications of the Act with respect to independent producer regulation, gave no indication that the Commission doubted its power to adopt the challenged regulations, which, unlike the requested legislation, have prospective effect only.

ARGUMENT

Petitioner's basic contention is that the Commission order rejecting its filings was based on invalid Commission regulations. Its preliminary contention (Br., pp. 8–18) that even if these regulations, which provide for rejection of producer certificate applications and rate schedule filings based on contracts containing proscribed price-changing provisions, were valid, the Commission may not reject its filings without a hearing is, in fact, no more than a challenge of the regulations which provide for such summary rejections. And, in any event, as we discuss more fully below, *infra*, pp. 36–41, the validity of rejection without hearing of unauthorized certificate or rate filings has been fully established. See, *e.g., United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, 205; *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 347; *Amerada Petroleum Corp.* v. *F.P.C.*, 293 F. 2d 572 (CA10), certiorari denied, 368 U.S. 976. Therefore, it is apparent that the only real issue before the Court is the validity of the challenged regulations.

I. The Commission had a reasonable basis for issuing the regulations limiting the types of rate-changing provisions permissible in producer contracts

The regulations which petitioner challenges do not, as it seems to imply (*e.g.*, Br. pp. 18, 45), proscribe all contract provisions for price flexibility. On the contrary, the regulations permit a number of types of price escalation clauses providing broad pricing flexibility over the customary long terms of these contracts without the needless complexities, arising from the proscribed clauses, which frustrate regulation; without inducing

the filing of many rate increases irrespective of economic justification, as the proscribed clauses would; and without permitting contract price instability, which frustrates the full regulatory protection for the consumer that the Commission's certificate authority was intended to provide.

In issuing rules under Section 16 of the Gas Act which it deems "necessary or appropriate to carry out the provisions" of the Act, the Commission must, of course, have a reasonable basis for the exercise of its judgment. See, *e.g., American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298, 314; *Air Line Pilots Association, International* v. *Quesada,* 276 F. 2d 892, 898 (CA2) and 286 F. 2d 319 (CA2), certiorari denied, 366 U.S. 962. The challenged rules clearly meet this test. For while, as petitioner emphasizes (Br. pp. 15, 35), the Natural Gas Act did not itself abrogate private gas sales contracts as such, this does not mean that the Commission must tolerate contract provisions, such as the price-changing provisions proscribed here, which in themselves thwart the effective rate regulation which the Act is intended to provide. Indeed, as we discuss, *infra,* pp. 29–36, contracts while not abrogated by the Act itself, remain subject to the paramount regulatory authority of the Commission. On the basis of its experience the Commission found in Orders 232 and 232A that the indefinite price changing provisions there proscribed hinder effective regulation of natural gas companies, and that the permitted price-changing provisions afford a sufficient means of achieving desirable price flexibility in long-term contracts. Order 242 did not make any substantive changes in those proscriptions, but merely spelled out the consequences that would ensue if contracts containing any of the proscribed provisions were offered in Commission rate or certificate proceedings.

A. The price-changing provisions permitted by the regulations provide all the price flexibility that is reasonably necessary

It should be emphasized at the outset, in view of petitioner's claims that the challenged regulations limit the prices that may be charged in the future, that these regulations control only the type of contract provision allowed, not the prices to be

charged, and, as we have said, do not even proscribe all indefinite pricing provisions.

The Commission was clearly reasonable in believing that the permitted price-changing provisions—fixed periodic price increases, increases reflecting certain tax increases, and price redeterminations every five years based on jurisdictional rates not questioned in rate suspension or certificate proceedings (Section 154.93 of the regulations, 18 C.F.R. (Cum. Supp. 1962) 154.93)—offered producers a broad scope of alternative price-changing provisions in long-term contracts that are more than adequate to meet all their legitimate needs.[8] This is illustrated by the fact that even before issuance of Orders 232 and 232A the Commission had approved at least 119 rate settlements in which producers agreed with the pipelines to substitute fixed periodic increases for favored-nation and price-redetermination clauses in existing contracts. See, *e.g.*, *Petroleum Leaseholds, Inc.* (Operator), 21 FPC 799; *Nemours Corporation* (Operator), 23 FPC 84. Many more such settlements have been agreed to since that time even though the regulations in no way affect contracts executed prior to April 3, 1961. Furthermore, many producer gas sales contracts, including some of Superior's own contracts on file since prior to the challenged regulations, provide only for fixed price periodic increases and tax reimbursement increases.

Nevertheless, because many producers sought permission after the issuance of Order 232, to have more flexible pricing provisions than that order allowed, the Commission concluded that within specified limits, price-redeterminations no more frequently than once every five years would be permissible, provided such increases were based upon and not higher than producer rate or rates subject to Commission jurisdiction and not questioned in suspension or certificate proceedings.

Contrary to petitioner's assertions (*e.g.*, Br. pp. 18, 45), the regulations at issue here impose no price ceilings on producer escalations for there is no limit on the frequency or amount of

[8] Moreover, there is nothing in the challenged regulations which precludes a producer from selling under a short-term contract at the termination of which it would be free to file rate changes at will. See *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 137, 155.

permissible fixed escalations.[9] Rather, the regulations affect only the triggering mechanisms for filing such increases. If a producer were in a bargaining position to require inclusion of the proscribed indefinite escalation provisions prior to the regulations, it is not apparent why it cannot insist on higher or sufficiently frequent periodic escalations to permit it to obtain the same prices throughout the term of a contract, without the same undesirable and regulation-impeding consequences discussed hereinafter (*infra*, pp. 18–28).

If as producers have sometimes contended, indefinite periodic price adjustment is necessary to induce them to make commitment of a large gas supply which might otherwise be sold in smaller and segmented packages so as to take advantage of possible increases in market prices, the allowable price-redetermination clause would achieve that result. For there is no reason to assume that, in a given area, new sales from previously undedicated acreage would be certificated at prices in excess of prices previously authorized by the Commission.

In any event, while indefinite escalation clauses may have had some justification when they were developed in the 1940's this no longer exists. Then it was uncertain how strong the demand for natural gas would become, there was still a lack of purchaser outlets, and the Commission had not undertaken to regulate producer prices. But now, as the Commission explained in *Pure Oil Co.*, 25 FPC 383, at 391, affirmed, 299 F. 2d 370 (CA7),

> * * * purchasers of gas are numerous, consumer demand is strong, and buyers are competing eagerly for available supplies of gas. In our judgment, in the light of continuing increases in the price of gas in recent years and the present high level of prices, escalation clauses such as Pure's have by now outlived whatever economic function they may have had.

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[9] Petitioner's misconception of the regulations is also illustrated by the completely unfounded view, expressed in its petition for rehearing of Order No. 242 (App. D, *infra*, p. 67), that the regulations limit periodic escalations to one cent per Mcf every 5 years or to a total increase of 3 cents per Mcf during a twenty year contract.

In present circumstances, not only because supply and demand is much more in balance, but also because of the actual Commission regulation now exercised over producer prices, companies are much more able to project, even over a twenty-year contract period, what specific escalations would be needed to file for rates the Commission would approve. That, of course, is the only relevant yardstick since, under regulation of producer prices, price escalation provisions provide only the basis or authorization for making an increased-rate filing, with the actual rates being subject to full Commission review. See, *e.g.*, *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 137, 152–153.

Moreover, it should be noted that in the event that special or changed circumstances exist when a producer seeks to make certificate or rate filings based on contracts containing non-permissible price changing provisions, it would be free to make such a showing at the time of filing and may, at that time, seek modification or waiver of the challenged regulations.[10]

Petitioner made no request for a waiver here.

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[10] Section 1.7 (a) and (b) of the Commission's regulations provides:

"(a) *General.* Petitions for relief under any statute or other authority delegated to the Commission shall be in writing and under oath, shall state clearly and concisely the petitioner's grounds of interest in the subject matter, the facts relied upon, and the relief sought, and shall cite by appropriate reference the statutory provision or other authority relied upon for relief and shall conform to the requirements of §§ 1.15 and 1.16." 18 C.F.R. 1.7(a).

"(b) *For issuance, amendment, waiver, or repeal of rules.* A petition for the issuance, amendment, waiver, or repeal of a rule by the Commission shall set forth clearly and concisely petitioner's interest in the subject matter, the specific rule, amendment, waiver, or repeal requested, and cite by appropriate reference the statutory provision or other authority therefor. If a rate filing is accompanied by a request for waiver pursuant to this section the thirty-day notice period provided in section 4(d) of the Natural Gas Act and section 205(d) of the Federal Power Act shall begin to run if and when the Commission grants the request. Such petition shall set forth the purpose of, and the facts claimed to constitute the grounds requiring such rule, amendment, waiver, or repeal, and shall conform to the requirements of §§ 1.15 and 1.16. Petitions for the issuance or amendment of a rule shall incorporate the proposed rule or amendment." 18 C.F.R. 1.7(b), as amended, Order No. 255, 27 Fed. Reg. 9499, September 26, 1962, and 27 Fed. Reg. 11001, November 6, 1962.

B. The Commission reasonably concluded that the proscribed clauses impede effective regulation

1. The proscribed clauses induce the filing of rate increases irrespective of economic justification

Not only are the proscribed contract provisions unnecessary to protect the legitimate business interests of independent producers but, as we now discuss, the Commission had ample reasons for concluding that the proscribed type of clauses impeded effective regulation.

The Commission found the proscribed indefinite escalation clauses inconsistent with effective regulation for several reasons. Initially, it is important to remember that the Natural Gas Act contemplates that increased rates will be filed only if two factors are present. First, there must be no contractual or other legal inhibition to a filing. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332; *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division*, 358 U.S. 103; *Amerada Petroleum Corp.* v. *F.P.C.*, 293 F. 2d 572 (CA10), certiorari denied, 368 U.S. 976.

Second, the proponent of the increased rate must go on record that the new rate is economically justifiable and that the rate is filed on that basis. For Section 4 (a) and (b) of the Act imposes a positive duty upon natural gas companies to charge rates that are just, reasonable and not unduly discriminatory or preferential and makes it the responsibility of the Commission to provide the sanctions that will enforce that duty. See *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246. To implement the latter consideration, the Commission's regulations require pipeline companies to furnish extensive cost information to support their increased rate filings. Section 154.63 of the Commission's regulations, 18 CFR 154.63, as amended, 27 Fed. Reg. 9500 (September 26, 1962). Such pipeline filings usually relate to all of the company's rates and services. Major independent producers, whose increased rate filings generally relate only to a single rate schedule, are required to submit a "full statement in support of the proposed change in rate" if it is higher than the applicable area price. Section 154.94(f) of the Commission's

regulations, 18 CFR 154.94(f), as amended, 27 Fed Reg. 252 (Jan. 10, 1962). In addition, the Commission expects the proponent of an increased rate to stand ready to make an immediate showing that his new rate is just and reasonable since Section 4(e) of the Act imposes that burden of proof upon him. Thus, in *H. L. Hunt, et al.*, 28 FPC——, 46 PUR 3d 62, the Commission dismissed, after hearing and prior to the end of the five-month suspension period, a number of increased rate filings where the producers had failed to make out a *prima facie* case in support of those findings. See also *e.g.*, *F.P.C.* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145; *Episcopal Theological Seminary* v. *F.P.C.*, 269 F. 2d 228 (C.A.D.C.), certiorari denied *sub nom. Pan American Petroleum Corp.* v. *F.P.C.*, 361 U.S. 895; *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 236 F. 2d 606 (C.A.3).

Partly in recognition of these considerations, the Commission issued its regulations limiting the types of price-changing provisions that would be permissible in producer contracts. For the indefinite price escalation provisions which the Commission declared to be against public policy were found to have induced rate increases to be filed which were nowise, even ostensibly, predicated on the economic needs of the producer at the time of the filing.[11] This is so because favored-nation and unlimited price-redetermination clauses, similar to those included in petitioner's contract here, contractually authorize a price increase by the seller under a particular contract solely on the ground that sellers under other contracts in the same general area have contracted to sell or are selling at higher prices. The Commission's experience demonstrated that when such contracts have been made or such higher prices have been collected, producers with such favored-nation or price-redetermination provisions have filed to increase their prices as quick-

[11] Superior, in its brief (pp. 20, 43–44, 47–48), distorting the Commission's statement, not only erroneously claims that the Commission said the price-changing provisions themselves (rather than the filings thereunder) are not ostensibly based upon economic justification, but ignores that essential difference in attacking the reasonableness of the Commission's conclusions. In permitting multiple fixed escalation or limited price redetermination provisions the Commission recognized the desirability of some additional flexibility "to cope with possible changing economic conditions over the span of long-term contracts" (see Order No. 232A, 25 FPC 609), but not at the expense of impeding effective regulation.

ly as possible solely for that reason.[12] As the Commission explained in its *Pure Oil Co.* decision, rendered after an extensive hearing relating specifically to the validity of a favored-nation provision (25 FPC at 389):

> * * * There need be no economic or other substantial justification for the increase; the mere fact that a higher price is paid to some other producer would be sufficient to activate the increase. In our view, such an artificial ground for a proposed increase, operating in such a mechanical and arbitrary manner, and lacking any substantial relationship to the factors which bear on the value of gas or on a determination of a reasonable level of rates for it, does not constitute a proper basis for filing proposed increased rates or a sufficient justification for our giving effect to such a filing * * *.

And, of course, as we have discussed, *supra,* pp. 15–16, the restriction on the types of permissible price-changing provisions in producer contracts does not "cut off other avenues by which a producer may make provision for filing of increased rates" (Pet. Br. App. B, p. 15a, 27 FPC at 340).

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[12] The impact on consumers from the favored-nation clause increases related to the *Pure Oil* case, were described by the Commission as follows (25 FPC at 389):

"* * * Thus, evidence adduced by El Paso indicates that escalation increases under clauses like those of Pure if activated by West Texas' sales will total some 18 million dollars annually. Furthermore, El Paso states that the filing of such increases for its gas supply will require the company to file for proposed increases in its rates. And it points out that by reason of spiral escalation clauses in its contracts with Phillips Petroleum Company, Phillips is entitled to and probably will file for an increase based upon El Paso's increase to its customers. Since Phillips will be permitted to collect this increase under refund obligation, says El Paso, once again the other producers will be entitled to file for increased rates under their escalation provisions and the cycle will start anew. According to El Paso, if the Pure rate increases here sought become effective, El Paso's gas purchase costs directly and indirectly will be increased in amounts ranging from $35 million to $51 million annually, in excess of El Paso's rate increases sought in its rate filing in Docket No. G–17929." [Footnote omitted.]

2. The proscribed clauses raise needless complexities frustrating rate regulation

a. Difficulties in determining contract authority to file.— Not only has the Commission's experience shown that the escalation provisions of the type proscribed have resulted in a flood of almost simultaneous filings without any indication that such filings were even ostensibly predicated upon the financial needs of the filing company, but the difficulties of determining whether there is contractual authority for such filings under such clauses has created an administrative problem of major proportions. The complexity of such contract provisions requires the Commission to spend an undue time interpreting contract price escalation provisions at the expense of determining whether the rates are just and reasonable. This conflicts with the mandate in Section 4(e) that the Commission shall give preference to the hearing and decision of questions relating to the reasonableness of increased rates "over other questions pending before it and decide the same as speedily as possible." The contract interpretation problem stems from the fact, as held in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.* 350 U.S. 332, that under Section 4(d) and (e) of the Act the Commission must reject increased rate filings if they are contractually prohibited. Accordingly, the *Mobile* case imposes a burden upon the Commission to determine in the first instance whether an increased rate filing is contractually authorized.

Of course, if an increase is based on a contract provision permitting an increase to a specific amount on a particular date, no difficult contract interpretation problem arises and hence such provisions were not proscribed, no matter how great their frequency or how great the permissible rise. But when filings are based on increased rates under other sales, complicated factual and interpretative problems frequently must be resolved at the threshold to determine if a tendered rate filing is in fact contractually permitted. *Pure Oil Co.*, 25 FPC 383, affirmed, 299 F. 2d 370 (CA7), is illustrative of this point. One of the favored-nation clauses there involved provides (25 FPC at 386):

> * * * In determining whether the price payable under such other contract or agreement is "higher" than the price payable for gas under this agreement, due consideration shall be given to the provisions of this agreement as compared with such other contract or agreement as to quantity and quality of gas, delivery pressures, gathering and compressing arrangements, provisions regarding measurement of gas, taxes payable on or with respect to such gas, and all other pertinent factors.

That clause, which is typical of many proscribed escalator provisions, shows that before it can be ascertained if a higher price is being paid under another contract so as to justify an increased rate filing, the Commission must make numerous comparisons to fulfill its *Mobile* obligation.[13] In *Pure,* the Commission observed (25 FPC at 390):

> * * * According to staff, a comparison of all the factors listed in the contracts involved herein would necessitate many dozen different comparisons. At the least, as this case demonstrates, the interpretation and application of such clauses involve controverted factual problems and difficult legal questions. * * *

And while questions of contract construction are not within the area of Commission expertise to which the courts should defer,[14] when a rate is filed the Commission, under *Mobile,* must initially construe that contract, regardless of the weight

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[13] The triggering under the proscribed favored-nations and price redetermination clauses in Superior's contract depends upon similar comparisons. Thus under the favored-nations clause the triggering occurs if the buyer pays another seller a higher price "for comparable gas delivered under comparable conditions" (R. 32). The redetermination clause similarly requires "consideration" of "all pertinent factors."

[14] In *Pure Oil* v. *F.P.C.*, 299 F. 2d 370, 373, 374 (CA 7), while the court held that the scope of certain contract language, namely, the scope of the comparability language quoted above and particularly the meaning of "all other pertinent factors", was not a matter of Commission expertise, the evaluation of the comparative factors—there whether the gas involved in the triggering sale possessed exceptional qualities for peaking purposes so that the price was not comparable—was regarded by the Court as matters "subject to the application of the Commission's expert knowledge and judgment in a technical field," which the court could not review *de novo.*

its construction receives on judicial review. The history of the *Shell* litigation, which twice reached the Supreme Court, gives ample demonstration that the question of whether a favored-nation clause was triggered may involve very difficult and complex questions of contract law, capable of being resolved only after extended litigation. See *Texas Gas Transmission Corp.* v. *Shell Oil Co.*, 363 U.S. 263; on remand to the Third Circuit, *Shell Oil Co.* v. *F.P.C.*, 292 F. 2d 149 (CA 3), certiorari denied, 368 U.S. 915.[15]

In this connection it should be emphasized that, contrary to petitioner's assertions in attempting to rely (Br. pp. 9–10, 51) on certain language in *Mississippi River Fuel Corp.* v. *F.P.C.*, 202 F. 2d 899, 902–03,[16] the administrative difficulties which the regulations are intended to cope with do not arise from shortages in funds or personnel and would not be avoided by additional funds or personnel. Rather the problem is raised by the needless complexity of the price-changing provisions proscribed. For while the Act contemplated that rates would be initiated by private contracts, there is nothing in the Act or its history to even suggest that provisions in con-

[15] The Commission's contract construction was ultimately affirmed in this litigation, after the Supreme Court reversed the court of appeals as to what type of price would trigger a particular favored-nations clause. The second court of appeals opinion resolved a contract construction question not reached by that court originally.

[16] It should be noted that in the *Mississippi River Fuel* case, *supra*, the Court set aside the Commission order only because it overruled the Commission's conclusion that its regulations had not been complied with, so that the procedure there followed in dismissing an increased rate filing was invalid because the Commission relied on a distorted interpretation of the "otherwise clear words of a regulation it has itself adopted." 202 F. 2d at 902. It did not hold that the Commission may not exercise its rule-making authority under Section 16 to make regulation more manageable. Indeed, the Court stated it had no doubt that the Commission could by regulation require rate "schedules and supporting data to be organized or broken down in convenient and readily comprehensible form" (202 F. 2d at 902), *i.e.*, regulations to enable more effective administration of the Act. The court expressly assumed (202 F. 2d at 901) that the Commission could "reject" a proposed filing which did not conform to such Commission rules or regulations. In *Atlantic Seaboard Corp.* v. *F.P.C.*, 201 F. 2d 568, 570–571 (CA4), the court similarly approved the Commission's authority to make such regulations and to reject filings which are not in conformity with such regulations.

tracts which are vestigial remainders of an unregulated era of gas production must be permitted to frustrate regulation.

And such frustration results if contracts are so involved and complex that extensive hearing or argument is required to ascertain in the first instance whether a filing is contractually authorized.[17] A natural gas company, before putting a new rate into effect is required to give thirty-days' notice to the Commission and the public pursuant to Section 4(d) of the Act. The Commission may suspend such a rate for five-months, but thereafter the rate may be put into effect subject to refund. As the Tenth Circuit has said, the "obvious purpose for granting suspension powers to the Commission was to provide a status quo of five months during which the Commission could investigate the *reasonableness* of the proposed new rate schedule." [Emphasis supplied.] *Phillips Petroleum Co.* v. *F.P.C.*, 227 F. 2d 470, 474 (CA10), certiorari denied *sub nom. Michigan Wisconsin Pipe Line Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005. But in a case such as *Pure Oil Co., supra,* the Commission is faced with a threshold question of contract interpretation and application which delays and even prevents consideration of the reasonableness question during that time.[18]

[17] It may be noted that the price-redetermination provision in petitioner's contract might require the Commission to determine a "reasonable market price," assuming that is different from a just and reasonable rate, before it could fulfil its duty to determine the just and reasonable rate. Under that clause (R. 31) if the seller requests a redetermination, the parties shall "attempt to determine the then reasonable market price of the gas." No provision is made for determining the price in the absence of agreement. Assuming such a clause is enforceable (see *Beech Aircraft Corp.* v. *Ross*, 155 F. 2d 615 (CA10); but see Restatement of Contracts, Section 32), a filing by the seller absent such agreement might require a threshold determination by the Commission of whether the rate filed represented the "reasonable market price" within the meaning of the contract. In addition, the Commission might also have to decide whether, absent agreement by the parties, a new rate could be filed at all prior to a judicial determination of the "reasonable market price."

[18] While such rates would presumably be collected subject to refund after a five months suspension, it has been recognized that that remedy by no means affords consumers the full protection from excessive charges which is the primary purpose intended to be achieved by the Natural Gas Act. As the Supreme Court has recently stated in *F.P.C.* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145,

"* * * True, the exaction would have been subject to refund but experience has shown this to be somewhat illusory * * *. It is, therefore, the duty of

b. Uncertainty as to level of claimed triggering price.—Another impediment to effective regulation arising from the proscribed provisions grows out of the fact that the precise amount of the contractually permitted price increases may be unascertainable until the level of the triggering price or prices is finally determined in a Commission rate proceeding on the triggering sale price. See, *e.g., Phillips Petroleum Co.* v. *F.P.C.*, 227 F. 2d 470 (CA10), certiorari denied *sub nom. Michigan Wisconsin Pipeline Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005. Indeed, under the favored-nation clause in Superior's contract (R. 32), El Paso is to pay Superior as much as it is paying to others for comparable gas. But if a higher amount to another seller is being paid subject to a Commission imposed obligation to refund in certain contingencies, it would seem apparent that the amount to which Superior would be contractually entitled for sales on any given date could not be ascertained until the contingency of the triggering rate is removed. Similarly, under a redetermination clause, such as that in Superior's contract here, the contract rate may not have been determined at the time of filing.[19] In such circumstances, the Commission, at the time such an indeterminate rate is filed, does not have the opportunity efficiently to exercise its discretion as to whether the proposed increased rate should be suspended and set for hearing since it cannot then know the actual level of the proposed increased rate.

3. *The proscribed clauses prevent proper consideration of all relevant factors in certificate regulation*

a. Producer certificates.—In addition to frustrating effective rate regulation the proscribed clauses also constitute an impediment to effective certificate regulation. As this Court is aware, in issuing certificates to producers the Commission has

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the Commission to look at the 'backdrop of the practical consequences [resulting] * * * and the purposes of the Act,' *Sunray Mid-Continent Oil Co.* v. *Federal Power Comm'n.*, 364 U.S. 137, 147 (1960), in exercising its discretion under § 16 to issue interim orders * * *."

[19] For example, in *Pan American Petroleum Corp.*, FPC Docket No. RI63–3, the producer has filed for an increased rate based on a redetermination clause calling for a "fair and reasonable" price, the amount of which was still in litigation at the time of filing. See suspension order in that proceeding of July 12, 1962, 27 Fed. Reg. 6856 (July 19, 1962).

an obligation to determine the impact of proposed producer prices and to "hold the line." *E.g., Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378; *United Gas Improvement Co.* v. *F.P.C.,* 283 F. 2d 817 (CA9), certiorari denied *sub nom. Superior Oil Co.* v. *United Gas Improvement Co.,* 365 U.S. 879, and *California Co.* v. *United Gas Improvement Co.,* 365 U.S. 881. Such an obligation obviously carries with it a responsibility to compare the terms of contracts, not just the initial price. *United Gas Improvement Co.* v. *F.P.C., supra,* 283 F. 2d at 823 (CA9).

To illustrate this, let us assume that in a given area the Commission had been unconditionally certificating sales where the contracts called for an initial price of 18¢ with no provisions for any type of price escalation for five years. At the same time, it has rejected certificates where the initial sales price was 19¢ on the ground that it was out of line, that collection of the 19¢ rate, even subject to refund, would trigger price increases, and that there was no need for gas at such a high price. It would seem apparent that a sales contract calling for an 18¢ price for the first thirty days of delivery, with an escalation to 19¢ thereafter would be equally as objectionable as the initial 19¢ price. An 18¢ initial price which could be escalated under a favored-nations clause at any time would also appear to be equally objectional, because the 19¢ price might be reached just as quickly. This example shows why the Commission has regarded it as necessary to fulfill its function of giving "a most careful scrutiny and responsible reaction to initial price proposals of producers under § 7" (*Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378, 391) to look at more than just the price for the first day of delivery to determine if the price provisions of new contracts are comparable to those previously approved. [20] However, as long as

[20] See *Trunkline Gas Co.,* 21 FPC 704, petition for review dismissed, *sub nom. Public Service Commission of New York* v. *F.P.C.,* 284 F. 2d 200 (CADC). There the Commission, in certificating a higher initial price than any previously approved, explained (21 FPC 719): "* * * these contracts provide for a firm 20 cent price for a period of ten years, without escalations or redeterminations. We look with favor on such firm contracts which serve to relieve the pressure on the rising spiral of producer prices caused by the usual provisions for escalations and redeterminations found in most contracts. We emphasize, however, that in the absence of this provision for

new producer contracts contained completely indefinite price escalation provisions a meaningful comparison with other contracts could not be made except in rare instances. Standardization of the triggering mechanisms allowed in producer contracts will contribute to permitting more realistic comparisons in the Commission's effort to comply with this and other courts' repeated commands to "hold the line".

b. Pipeline certificates.—Moreover, the existence in producer contracts of the proscribed escalation provisions has also, as was found in Order 232 (App. A, *infra,* p. 50), "contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies." This is so because one of the prerequisites to issuance of a certificate of public convenience and necessity to a pipeline company for new facilities is a showing that a sufficient market exists to justify the new construction. See, *e.g., Kansas Pipe Line & Gas Co.,* 2 FPC 29, 45–46. Such a showing, of course, includes evidence as to the market of the distribution companies. While this type of showing necessarily will depend upon estimates of sales and revenues, such estimates even for the three to five year period after commencement of service will be very speculative, at best, if the gas supply for the project is based

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a firm price, we would not be persuaded that the 20 cent price is required by the public convenience and necessity; and, it will not be sufficient for producers hereafter seeking certificates to support their applications by reference to our action in this proceeding without taking proper account of this factor of firm price. We shall closely scrutinize any such proposed sales in this area under contracts which provide for price escalations or redeterminations above 20 cents per Mcf within a period of five years, and in the absence of a clear showing that such prices are required by the public convenience and necessity, we shall either deny the applications or impose price conditions."

And in establishing its area price for increased rates with respect to four Texas districts the Commission has varied the level depending on the terms of the contracts involved. Section 2.56 of the Commission's regulations, 18 CFR 2.56. Thus, while increases to 14 cents will be suspended if there is no limitation on the price changing provisions, increases to 14.6 cents will not be suspended if favored-nation and price-redetermination provisions have been eliminated, while 15 cent rates will not be suspended if periodic escalations have been eliminated as well. In making this distinction, the Commission has relied upon its action in accepting numerous settlements as to rates for sales from those areas, including contract renegotiations making such modifications.

upon contracts containing provisions such as the proscribed favored-nation and unlimited price redetermination clauses. For in such circumstances no *maximum* gas supply cost can be realistically estimated by the distributing company and hence the "estimates" as to number of prospective natural gas consumers, which depend in part at least on the relative costs of natural gas, fuel oil or coal, cannot be realistically evaluated. As a result of the increases in the cost of natural gas that had occurred for ten or fifteen years, until recently checked, the competition with other fuels has become more acute. See, *e.g., Northern Natural Gas Co.*, 22 FPC 164, 523, affirmed *sub nom. Minneapolis Gas Co.* v. *F.P.C.*, 278 F. 2d 870 (CADC), certiorari denied, 364 U.S. 891; see also, *Hearings on the Natural Gas Act (Exemption of Producers) before the House Committee on Interstate and Foreign Commerce,* 84th Cong., 1st Sess., pp. 631, 811–818, 824–828. These circumstances provided further substantial basis for the regulations by providing not only a sounder basis for the Commission to evaluate prospective market demand in pipeline certificate proceedings, but also by permitting more realistic planning for pipeline development and expansion.

The foregoing considerations show that the Commission had a reasonable basis for promulgating the challenged rule. To affirm the Commission, the Court does not, however, have to agree with all of the Commission's conclusions or decide that it would have acted precisely as the Commission did. For it is the function of the Commission, not the courts, to legislate interstitially and the courts will set aside such actions only if no reasonable predicate therefor is apparent, even if the court might disagree with the wisdom of the regulation. See, *e.g., American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298, 314; *American Telephone & Telegraph Co.* v. *United States,* 299 U.S. 232, 236–237.

II. The Commission has authority to regulate contract provisions by rule

An important part of Commission regulation of public utilities is through the issuance of general rules and regulations fixing detailed rights and duties to carry out or administer the

terms of the regulatory statute without the necessity for case-by-case decision of the same issue with respect to every individual utility. The Federal Power Commission's authority to issue rules and regulations is specifically set forth in Section 16 of the Natural Gas Act, which provides in pertinent part:

> The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. * * *

As the Tenth Circuit has recently had occasion to conclude, this is "a sweeping grant of administrative authority to be exercised in the sound discretion of the Commission." *Amerada Petroleum Corp.* v. *F.P.C.*, 293 F. 2d 572, 575, certiorari denied, 368 U.S. 976. And while we agree with petitioner (Br. p. 34, 36) that this broad authority may not be used in a manner inconsistent with the Act, the Commission's rules in this case are not only not inconsistent with the Act but are, indeed, predicated on the substantive powers found in specific sections of the Act. In issuing the challenged rules, the Commission was thus legislating interstitially, as contemplated by the Act. See, *e.g.*, *S.E.C.* v. *Chenery Corp.*, 332 U.S. 194, 202; *American Trucking Associations, Inc.* v. *United States*, 344 U.S. 298, 308–313.[21]

A. Sections 4 and 5 of the Natural Gas Act authorize regulation of contracts of natural gas companies

Petitioner is simply wrong in contending that the Natural Gas Act precludes the Commission from modifying contracts.

[21] Petitioner's contention (Br., p. 37) that the Commission's rule-making authority is limited to procedural rules is not supported by *Willmut Gas & Oil Co.* v. *F.P.C.*, 294 F. 2d 245 (CADC), certiorari denied, 368 U.S. 975, upon which it seems to rely in this respect. There the court concluded only that Section 16 would not permit the Commission to promulgate rules inconsistent with the statute and thus result in a legislative change. It should be noted that this discussion in *Willmut* related not to an actual Commission regulation but rather to hypothetical regulations which petitioner there argued that the Commission should have adopted to prevent pipelines from filing general tariff increases while a previously filed increase was still pending before the Commission.

This view as to lack of such substantive power is impossible to reconcile with the Commission's express authority to change "*contracts,*" as well as rates. In this section we consider the substantive question of the existence of the authority; in a subsequent section we discuss the question whether such authority may be exercised only on a case-by-case basis or also by rule or regulation (*infra,* pp. 36–41).

Section 5(a) of the Act provides that in passing on existing rates or contracts affecting rates

> Whenever the Commission, after a hearing * * *, shall find that any * * * *contract* affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable * * * *contract* to be thereafter observed and in force, and shall fix *the same* by order * * * [emphasis supplied].

Section 4(e) gives the Commission the same powers over contracts when a company files a changed rate or contract. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.,* 350 U.S. 332.[22]

The power to modify contracts has been judicially recognized. Thus, in *Mississippi River Fuel Corp.* v. *F.P.C.,* 252 F. 2d 619 (CADC), certiorari denied, 355 U.S. 904, the court sustained a Commission order requiring United Gas Pipe Line Company to disregard a contractual obligation to provide Mississippi with all its natural gas requirements and to insert a take-or-pay clause in the contract. In *Michigan Consolidated Gas Co.* v. *Panhandle Eastern Pipe Line Co.,* 226 F. 2d 60 (CA 6), certiorari denied, 350 U.S. 987, the court recognized the Commission's authority to free Panhandle of a contractual duty to supply Michigan Consolidated a specified amount of gas. See also, *e.g., El Paso Natural Gas Co.,* 13 FPC 421, 456–457 (service agreement provisions dedicating gas from specified reserves to

[22] Section 4(e) states that in such a proceeding "the Commission may make such orders with reference [to a changed rate] as would be proper in a proceeding initiated after it had become effective." After a rate has become effective, a proceeding to determine the lawfulness of rates or contracts would be initiated pursuant to section 5(a).

sales to certain customers ordered eliminated). And, of course, when the Commission reduces a natural gas company's contractually established rate it alters the rate provided by the contract.

Petitioner's claim that under the *Mobile* case, *supra,* contract terms are immune from Commission modification are clearly frivolous. For while the Supreme Court there stated that the Natural Gas Act, unlike the Interstate Commerce Act, was not intended "to abrogate private rate contracts as such" (350 U.S. at 338), it also expressly recognized that "contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest" (350 U.S. 344). Indeed, in the *Mobile* case the issue was only whether a natural gas company had the right to file an increased rate pursuant to Section 4(d) of the Act when its contract prohibited that filing. Since the Supreme Court held that the Act was not intended to prohibit private rate contracts, it concluded that a seller of natural gas could not invoke the provisions of the Act for the filing of increased rates so long as a contractual inhibition was present. The Court in *Mobile* was concerned with the powers of the seller of natural gas, not with the power of the Commission as such. As we have seen, the Commission's paramount power was recognized and there is nothing in *Mobile* that in any way limits the express powers over contracts conferred by Sections 4 and 5 of the Act.[23]

[23] Indefinite price-changing provisions, though in existence to a limited extent in 1938, when the Act was adopted, did not become common earlier than the mid-1940's. See *e.g., Hearings on Natural Gas Act (Exemption of Producers) before House Committee on Interstate and Foreign Commerce,* 84th Cong., 1st Sess., p. 538; 96 Cong. Rec. 4022–4028; Neuner, "The Natural Gas Industry," p. 80–111 (1960). Thus, while allowing rates generally to be initiated by contract, Congress can hardly be charged with approving or even considering all types of contract provisions that might be developed. Moreover, by specifically granting the Commission power to find contracts unlawful pursuant to Section 5(a) of the Act, Congress recognized that the Commission, not Congress, should deal with the evils arising from specific contracting practices as the Commission should find necessary or appropriate. See *American Trucking Associations, Inc.* v. *United States,* 344 U. S. 298, 309-310.

B. Sections 7 (c) and (e) authorize Commission action with respect to rate structures and contracts in issuing certificates of public convenience and necessity

The Commission's power to modify contracts is at least as great in Section 7 proceedings on applications for certificates of public convenience and necessity, as in Section 4 or 5 rate proceedings. Here again we consider the substantive question of existence of the authority, reserving for consideration hereinafter, *infra,* pp. 36–41, how that authority may be exercised.

Section 7 (c) and (e) vest in the Commission the power and duty to control the terms and conditions under which natural gas companies may initiate proposed sales at wholesale prices or transport natural gas in interstate commerce. If a natural gas company does not find such terms and conditions acceptable to it, it is not compelled to initiate the proposed service. This is because there is no dedication to interstate commerce of its properties until gas commences to flow in interstate commerce. *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378, 387.

But the fact that a natural gas company may refuse to render service except on the terms stated in its certificate application does not require the Commission to approve service on those terms unless the public convenience and necessity will be advanced. As the Tenth Circuit has stated (*Sunray Mid-Continent Oil Co.* v. *F.P.C.,* 267 F. 2d 471 at 472, affirmed, 364 U.S. 137), a contrary conclusion would mean that a natural gas company could dictate the terms and conditions of every certificate. This, of course, would be inconsistent with the Commission's power to control initiation of service in order to make regulation more effective.

While the standard of public convenience and necessity is not capable of precise definition, the Commission must give the greatest possible effect to all provisions of the Act, and their policies, in applying this standard. See, *e.g. F.P.C.* v. *Transcontinental Gas Pipe Line Corp.,* 365 U.S. 1; *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378; *United States* v. *Detroit Navigation Co.,* 326 U.S. 236, 241; *cf., National Broadcasting Co.* v. *United States,* 319 U.S. 190, 215–220. Particularly in view of the fact that the primary aim of

the Act is "to protect consumers against exploitation at the hands of natural gas companies" (*e.g., Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 137, 147; *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610), the Commission must consider rate questions, including the terms of related contracts, in certificate proceedings. See, *e.g., Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378; *United Gas Improvement Co.* v. *F.P.C.*, 283 F. 2d 817, 823 (CA9). While in the *Atlantic Refining Co.* (*CATCO*) case it was held that the Commission was not required to convert every certificate proceeding into a hearing to determine the justness and reasonableness of the initial rates proposed, that case, contrary to petitioner's suggestion, does not preclude as thorough a consideration of either rate or contract matters in certificate proceedings as in a Section 4 or 5 rate case, if the Commission considers this feasible and desirable.

It is, in fact, apparent that when dealing with a rate structure or terms of service for a proposed sale, whether stated in a tariff or contract filed as a rate schedule, modification required by the public interest can be made prior to the commencement of service not only as readily but also, in many instances, with a less disruptive effect upon all parties. For at that time persons objecting to such modifications can still refuse to make or participate in the proposed service if the conditions required by the public interest were unacceptable to them.

The desirability of Commission examination of rate structures, and hence the contracts of which they are made up, before service starts was specifically recognized in Congress when Section 7 of the Natural Gas Act was amended in 1942 to require certificates of public convenience and necessity prior to initiation of any new jurisdictional service.[24] At the same time Congress also added Section 7(e), which prescribes the standards to be applied by the Commission in deciding if a proposed act or service should be authorized. The purpose of these amendments was explained by the House Committee on

[24] Prior to that time, certificates were required only if a company sought to enter a market already being served by another natural gas company.

Interstate and Foreign Commerce in these terms (H.R. Rep. No. 1290, 77th Cong., 1st Sess., pp. 2–3):

> * * * The bill when enacted will have the effect of giving the Commission an opportunity to scrutinize the financial set-up, the adequacy of the gas reserves, the feasibility and adequacy of the proposed services, and the characteristics of the rate structure in connection with the proposed construction or extension *at a time when such vital matters can readily be modified as the public interest may demand.* * * * [Emphasis supplied.]

The Senate Committee on Interstate Commerce made a similar explanation [S. Rep. No. 948, 77th Cong., 2d Sess., pp. 1–2]:

> Provisions of the Natural Gas Act empower the Commission to prevent uneconomic extensions and waste, but it can so regulate such powers only when the extension is to 'a market in which natural gas is already being served by another natural-gas company.' Thus the possibilities of waste, uneconomic and uncontrolled extensions are multiple and tremendous. The present bill would correct this glaring inadequacy of the act. It would also authorize the Commission to examine costs, finances, necessity, feasibility, and adequacy of proposed services. *The characteristics of their rate structure could be studied.* * * * [Emphasis supplied.]

See also Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 5249, 77th Cong., 1st Sess., pp. 5–6.

Aside from imposing conditions with respect to the initial prices proposed to be charged by natural gas companies, the Commission has also repeatedly found it necessary to require modification of other tariff or contract provisions as a condition to granting certificates of public convenience and necessity. *E.g., Florida Economic Advisory Council* v. *F.P.C.*, 251 F. 2d 643, 646, 648 (CADC),[25] affirming *Houston Texas Gas and Oil Corp.*, 16 FPC 118 and 17 FPC 303 (condition requir-

[25] Certiorari denied, 356 U.S. 959.

ing elimination of cancellation provisions in transportation agreement); *Northern Natural Gas Co.*, 22 FPC 164, 174–175, 180, affirmed *sub nom. Minneapolis Gas Co.* v. *F.P.C.*, 278 F. 2d 870 (CADC), certiorari denied, 346 U.S. 891 (certificate conditioned upon removal of clauses permitting cancellation depending on price relationship of gas and competitive fuels in gas purchase contracts upon which feasibility of pipeline project depended); *Transwestern Pipeline Co.*, 22 FPC 391, 394–395, modified on rehearing, 22 FPC 542 (minimum bill provisions of proposed tariff required to be modified); *Transcontinental Gas Pipe Line Co.*, 7 FPC 24, 38–40 (commencement of service conditioned upon filing of new tariff satisfactory to Commission because of disapproval of certain terms of service).

The cases upon which petitioner relies (Br. pp. 12–13, 32) fail to support the proposition that the terms of contracts for future sales (which is all that is involved here) are immune from modification by Commission action or cannot be made the basis for rejecting a certificate predicated thereon. To the contrary, the cases relied upon show that existing contracts are subject to Commission revision. Thus, in *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, the Supreme Court held that in issuing certificates the Commission had an obligation to consider the initial price to be charged for the proposed service and, if it issued a certificate, to impose price conditions if the initial price was excessive under Section 7 standards. Since the prices proposed by the producers were fixed by contract, such a price condition necessarily entails modification.

And in both *Texaco Inc.* v. *F.P.C.*, 290 F. 2d 149 (CA 5) (condition imposed after Section 7 hearing), and *H. L. Hunt* v. *F.P.C.*, 306 F. 2d 334 (CA 5), F.P.C. petition for rehearing pending (price condition in temporary authorization), the Fifth Circuit also approved the imposition of initial price conditions upon the issuance of producer certificates, which meant modification of the prices provided by the contracts. While in both of these cases the court held that the modified prices resulting from the Commission imposed "condition" would not provide the same bar under the *Mobile* case to filing of increased rates pursuant to Section 4 of the Act as obligations in a con-

tract of the parties between themselves, in neither case did the court suggest that the Commission could not by proper rule require modification in the form of producer contracts.

In the *Hunt* case, where a rate condition based on the Policy Statement area price was imposed which required a price lower than the contract price for the duration of the temporary certificate, the court also concluded that the Commission could not so condition the temporary authorization. That holding, as to which we petitioned for rehearing *en banc* on August 23, 1962, does not support petitioner, either. The basis of Judge Brown's holding in *Hunt* seems to be that once gas is flowing even under temporary authorization, the statutory right to file increases authorized by the seller's contract may not be taken away by the Commission. But his opinion does not touch the question of the reasonableness of Commission requirements limiting the contract provisions under which it will permit gas to start flowing.

Thus while both of these cases hold that there are limits to the Commission's certificate conditioning power, neither denies the Commission's power by certificate condition to modify the terms of a contract in a Section 7 certificate proceeding. To the extent that *Texaco* and *Hunt* limit the type of condition that the Commission may impose they are irrelevant here where the reasonableness of the Commission's basis for denying certificates based on contracts containing the proscribed indefinite pricing clauses is clear. And *Texaco* expressly states that the Commission could deny out of hand a certificate if the public convenience and necessity did not warrant granting it on the basis of the terms of the proposed contract. 290 F. 2d at 155.

C. The procedural provisions of Sections 4, 5 and 7 do not curtail Commission authority under Section 16 to carry out by general rule the regulation of contracts authorized by those sections

There is no basis for petitioner's contentions (*e.g.*, Br. pp. 8–18, 30–34) that the Commission cannot carry out the regulation of contracts authorized in Sections 4, 5 and 7, by general regulations issued under Section 16, because the provisions of Sections 4, 5 and 7 in terms call for hearings and findings prior

to Commission action on a rate or certificate filing. In this regard it should be noted that in issuing the challenged regulations the Commission was basing its actions on considerations applicable generally to independent producers; petitioner does not show or even suggest that the validity of the rate changing provisions, as opposed to particular rates, depends upon circumstances peculiar to itself. Its contention is simply that since the substantive authority to change contracts stems from Sections 4, 5 or 7, the Commission cannot, because of the hearing requirements of Sections 4, 5 and 7, achieve by rule-making that which it could achieve on a case-by-case approach. A virtually identical contention was rejected by the Supreme Court in *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192.

In the *Storer* case, which arose under the Communications Act, the court below had held, as petitioner argues here, that the general rule-making authority of that Commission could not be exercised to limit the right of applicants to a hearing, because the court felt that Section 309(b) of that Act, 47 U.S.C. 309(b), in specifically referring to a hearing prior to denial of any application meant that "any citizen who seeks a license for the lawful use of an available frequency has the undoubted right to a hearing before his application may be rejected." 220 F. 2d at 208. It, therefore, concluded that the rules there in issue,[26] insofar as they required the threshold denial of license applications inconsistent with the rule, were invalid. In reversing the court of appeals and upholding that Commission's authority to act by rulemaking, the Supreme Court said (351 U.S. at 202–203):

> We do not read the hearing requirement, however, as withdrawing from the power of the Commission the rulemaking authority necessary for the orderly conduct of its business. As conceded by Storer, "Section 309(b) does not require the Commission to hold a hearing before denying a licence to operate a station in ways contrary to those that the Congress has determined are in

[26] The rules limited the number of radio and television channels that any person could own or control.

> the public interest." The challenged Rules contain limitations against licensing not specifically authorized by statute. But that is not the limit of the Commission's rulemaking authority. 47 U.S.C. § 154(i) and § 303(r) grant general rulemaking power not inconsistent with the Act or law.
>
> This Commission, like other agencies, deals with the public interest. * * * [Footnote omitted.]

In reaching this conclusion, the Court had pointed out (351 U.S. 201–202):

> The Commission asserts that its power to make regulations gives it the authority to limit concentration of stations under a single control. It argues that rules may go beyond the technical aspects of radio, that rules may validly give concreteness to a standard of public interest, and that the right to a hearing does not exist where an applicant admittedly does not meet those standards as there would be no facts to ascertain. The Commission shows that its regulations permit applicants to seek amendments and waivers of or exceptions to its Rules. It adds:
>
> "This does not mean, of course that the mere filing of an application for a waiver * * * would necessarily require the holding of a hearing, for if that were the case a rule would no longer be a rule. It means only that it might be an abuse of discretion to fail to hear a request for a waiver which showed, on its face, the existence of circumstances making application of the rule inappropriate." [Footnotes omitted.]

The same considerations are applicable here. For at the time a certificate or rate filing was made, petitioner was free to seek waiver or modifications of the regulations and obtain a hearing if such a request showed on its face, reasons for such action. See, *supra*, p. 17. Petitioner did not request a waiver, but only contended that a hearing was required on any filing made pursuant to Sections 4 or 7 of the Act. It may be noted that the Commission has recently granted rehearing to consider whether the regulations here involved should be modified to

permit escalation clauses in producer contracts which allow producers to change the price under a particular contract at will, subject only to Commission regulations. *Atlantic Refining Co.*, F.P.C. Docket No. CI63–576, order issued February 21, 1963. In granting rehearing, the Commission observed that, while such a provision was clearly prohibited by Section 154.93 of its regulations, "the propriety of such a provision, which is not typically found in contracts between independent producers and pipelines, was not a matter which engaged the Commission's consideration at the time it adopted its present rule." Moreover, the Commission will provide a hearing if a question arises as to whether or not a particular contract contains non-permissible price changing provisions. Such a hearing is being held in *Atlantic Refining Co.*, F.P.C. Docket No. CI62–1562, pursuant to an order of September 13, 1962, granting rehearing of a rejection order, 27 Fed. Reg. 9362, September 20, 1962.

But otherwise there is no right to a hearing every time a proscribed contract provision is sought to be filed. The Power Commission, as shown above, *supra,* pp. 29–36, has fully established authority to regulate the terms included in contracts of natural gas companies in either rate or certificate proceedings. Here the challenged rule generally proscribes certain types of price-changing provisions which the Commission found to be contrary to the public interest in that their existence tended to frustrate the effective regulation contemplated by the Act. Petitioner, who has had the complete opportunity to submit written data, comments, or views prior to the issuance of the challenged rules (the procedure required for general rulemaking by Section 4(b) of the Administrative Act, 5 U.S.C. 1003 (b)),[27] contends only, as did Storer, that the Commission must proceed by a case-by-case method, even though no facts are in dispute and no circumstances are even suggested to differen-

[27] Petitioner's reference (Br., p. 36) to the Orders 232, 232A, and 242, by which the challenged regulations were promulgated, as "ex parte" orders does not comport with the facts. In this respect, it should be noted that in the *Storer* case, the Supreme Court observed that the rules there involved, which were issued upon the filing of written data, comments, views, and oral argument (18 Fed. Reg. 7796, December 3, 1953), and, as here, without any evidentiary hearing, had been promulgated after "extensive administrative hearings." 351 U.S. at 205.

tiate petitioner or its needs from other independent producers. As Judge Learned Hand stated (*National Broadcasting Co.* v. *United States*, 47 F. Supp. 940, 945 (SDNY), affirmed, 319 U.S. 190):

> * * * Such a doctrine would go far to destroy the power to make any regulations at all; nor can we see the advantage of preventing a general declaration of standards which, applied in one instance, would in any event become a precedent for the future. * * * [28]

See also *S.E.C.* v. *Chenery Corp.*, 332 U.S. 194; *Logansport Broadcasting Corp.* v. *United States*, 210 F. 2d 24 (CADC); 1 Davis, *Administrative Law, Treatise*, pp. 407–411 (1958)).

Moreover, as the Supreme Court also held in *Storer* in approving the provision of the challenged rules that provided for rejection without hearing of license applications in conflict with the standards announced by the rule (351 U.S. 192 at 205):

> * * * We do not think Congress intended the Commission to waste time on applications that do not state a valid basis for a hearing. If any applicant is aggrieved by a refusal, the way for review is open.

Rejection of unauthorized rate filings without a hearing is also firmly established. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 347; *Amerada Petroleum Corp.* v. *F.P.C.*, 293 F. 2d 572 (CA10), certiorari denied, 368 U.S. 976.[29] As has recently been stated in a case approving rejection

[28] In this respect, it should be reiterated that, in addition to following the requirements of rule-making procedures, the Commission was able to place reliance on its decision in *Pure Oil Co.*, 25 FPC 383, affirmed 299 F. 2d 370 (CA7), where the validity of a favored-nations clause was at issue. The Commission may, in either adjudicatory or rulemaking proceedings, rely on its accumulated experience in earlier proceedings and is, of course, not precluded from relying on decisions in prior cases as precedent on questions of law, including policy determinations such as those here involved. Any other course, would make either the judicial or administrative processes completely unworkable.

[29] Indeed, in *Sun Oil Co.* v. *F.P.C.*, 266 F. 2d 222 at 226 (CA5), affirmed, 364 U.S. 170, the Fifth Circuit, in a case where the Commission had rejected a certificate application and an initial rate filing, stated that there is "no need for the holding of a formal hearing and the taking of testimony where

by the Interstate Commerce Commission of a motor carrier's tariff where no certificate authority existed, a tariff or rate filing not based on certificate authority is properly rejected. *W. J. Dillner Transfer Co.* v. *United States,* 31 U.S. L. Week, 2414 (U.S.D.C.W. Pa.—three-judge court).

Moreover, in promulgating general rules, as in legislation there is no constitutional right to an evidentiary hearing. See, *e.g., Bi-Metallic Investment Co.* v. *State Board of Equalization,* 239 U.S. 441; *Bowles* v. *Willingham,* 321 U.S. 503, 519–520.

And, contrary to petitioner's unsupported claims (Br. pp. 14, 34), the Fifth Amendment does not necessarily protect persons from legislative action even if that action may result in a drastic economic impact. See *American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298. There the Court held (344 U.S. at 322–323);

> * * * As we have indicated, the rule-making power is rooted in and supplements Congress' regulatory scheme, which in turn derives from the commerce power. The fact that the value of some going concerns may be affected, therefore, does not support a claim under the Fifth Amendment, if the rules and the Act be related, as we have said they are, to evils in commerce which the federal power may reach. This being the case, appellants had no constitutional claim in support of which they are entitled to introduce evidence *de novo,* and the court did not err in sustaining the objection thereto. [Footnote admitted.] [30]

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no fact issue was presented." *Cf. Denver Stock Yard Co.* v. *Producers Livestock Marketing Association,* 356 U.S. 282, 287, affirming, *Producers Livestock Marketing Association* v. *United States,* 241 F. 2d 192, 196 (CA 10); *Sun Oil Co.* v. *F.P.C.,* 256 F. 2d 233, 240–241 (CA5), certiorari denied, 358 U.S. 872.

[30] While the challenged regulations here involved have only prospective effect, administrative rules which affected existing rights have also been judicially approved. Thus, in *Air Line Pilots Association, International* v. *Quesada,* 276 F. 2d 892 (CA2) and 286 F. 2d 319 (CA2), certiorari denied, 366 U.S. 962, the Administrator of the Federal Aviation Agency prescribed a regulation prohibiting pilots over age 60 from piloting carrier aircraft. Objection was made that this was arbitrary, discriminatory, violated existing collective bargaining agreements and was a denial of due process because individual hearings were not afforded. The Court, in upholding the author-

III. Rejection of petitioner's filings was not discriminatory

A. Petitioner's reliance on the *Memphis* case, which relates to pipeline companies, is misplaced

Petitioner's contentions (Br. pp. 21, 52–54) that the regulations are discriminatory because pipelines are not subjected to the same regulations are completely baseless. It is obvious that a mere difference in treatment of pipelines and producers does not invalidate a regulation. Section 16 of the Act specifically provides that "[f]or the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

Since soon after the Supreme Court's *Phillips* decision in 1954 (*Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672), the Commission's regulations have, in large measure, accorded different treatment to pipeline companies and independent producers. Thus the filing requirements in both certificate and rate proceedings are much less detailed for independent producers than for pipelines. Compare Sections 154.1 through 154.86 of the Commission's Regulations under the Natural Gas Act, 18 CFR 154.1–154.86, with Sections 154.91 through 154.103, 18 CFR 154.91–103 (relating to rates); also compare Sections 157.5 through 157.22, 18 CFR 157.5–157.22, with 157.23 through 157.31, 18 CFR 157.23–157.31 (relating to certificates). Similarly, while a uniform system of accounts has been prescribed for pipeline companies of all sizes, none has been adopted for producers, and there are different requirements with respect to annual reports. Clearly then petitioner's claim based on a mere difference is without any significance.

As we have shown, *supra,* pp. 18–28, the challenged regulations are reasonable as applied to independent producers and are required to permit effective regulation of the producer segment of the natural gas industry. And while price-changing provisions, which in effect permit the pipelines to make *ex parte*

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ity to issue such regulation, stated (276 F. 2d at 896): "* * * All private property and privileges are held subject to limitations that may reasonably be imposed upon them in the public interest. Only when the limitations are too stringent in relation to the public interest to be served are they invalid. * * *"

rate filings, are standard in pipeline service agreements (see, *e.g., United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division,* 358 U.S. 103), this is no indication of an arbitrary difference in treatment since no similar need for regulation has been experienced with respect to pipelines. This stems in large part from the fact that pipelines, unlike producers, do not seek rate increases for sales to individual distributing companies, but file instead company-wide increases to reflect overall increased costs in the operations. Moreover, in the case of pipelines, such company-wide increases are required by the applicable regulations to be supported at the time of filing by substantial cost data amounting to a full factual justification of the new rate. See Section 154.63 of the Commission's regulations, 18 CFR 154.63, as amended, 27 Fed. Reg. 9500 (September 26, 1962). Producers, by contrast, not only have continued to establish rates by individual contract but, in addition, their increased rate filings normally relate to such contracts or at most, to only a small portion of their total operation.

Furthermore, reliance (Pet. Br. pp. 25–26) on the language in *Memphis* (358 U.S. at p. 113) that "[b]usiness reality demands that natural gas companies should not be precluded by law from increasing the prices of their product whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance" is misplaced. For that language does not mean that any type of escalation provision however invidious must be tolerated. To the contrary, while the Court in *Memphis* stated that this objective of producing adequate revenues was taken into account by the Congress in part by "preserving the 'integrity' of private contractual arrangements for the supply of natural gas, 350 U.S. at 344," the Court also stated that such arrangements were *"subject of course to any overriding authority of the Commission."* [Emphasis added.] Here this overriding authority has, as discussed, *supra,* pp. 18–28, been exercised to prevent gas supply arrangements which by their very existence are an impediment to the effective regulation the Act was intended to achieve, a factor not found to exist by either the Commission or the Court in *Memphis.* Indeed, any other result in that case would have

meant that under the existing service agreements the pipeline would have been precluded from making any increased rate filings without approval of its customers, no specific escalation being authorized in any of the long-term service agreements.

B. The Commission was not required to accept petitioner's filings because it had accepted comparable filings based on contracts pre-dating Order 242

Petitioner's further contention (Br. pp. 19–22, 42–43) that the rejection of its certificate application and related rate filing was discriminatory because the Commission had at earlier dates granted certificates for sales on identical terms from the same field is patently without merit. As has been shown, the rejection of petitioner's filings here resulted from that fact that they were based on a contract executed subsequent to the effective date of Order 242; the similar filings to which petitioner refers all pre-date the present regulations promulgated by Orders 232A and 242. Petitioner, both before and after the adoption of the regulations limiting the types of price-changing provisions in producer contracts, was and is being treated the same as anyone else.[31] Neither it nor anyone else has a vested right to be granted a certificate based on certain types of contract provisions which the Commission had previously accepted. No prior Commission decision can bar its continuing reexamination of the facts or policy considerations as they affect the public interest. See *F.C.C.* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 156. The cases relied upon by petitioner in no way support its view that an intervening rule of general applicability does not fully explain and justify the differences in treatment of which it complains. In *Episcopal Theological Seminary* v. *F.P.C.*, 269 F. 2d 228, 237 (CADC), certiorari denied *sub nom. Pan American Petroleum Corp.* v. *F.P.C.*, 361 U.S. 895 (Pet.

[31] The certificate application and rate schedule filing of Humble Oil & Refining Company relating to Humble's fifty-percent interest in the same acreage here involved, to which Superior referred (R. 117) in its certificate application, was rejected for the same reasons as Superior's. Humble, however, thereafter amended its contract by making the favored-nations and price redetermination provisions of the contract adopted reference inapplicable to the post-Order 242 supplemental agreement. As amended, Humble's filings have been accepted.

Br. pp. 19, 43), the court merely indicated that unexplainable differences in treatment of similarly situated producers would not be permissible. However, it affirmed the Commission suspension of one company's increased rate, although another company's increased rate for a sale to the same buyer under the same contract had previously not been suspended, since it appeared that the earlier action had been inadvertent. In *Sohio Petroleum Co.* v. *F.P.C.*, 298 F. 2d 465 (CA10) (Pet. Br. p. 43), the court disapproved the Commission's requirement that a particular type of fuel adjustment clause be eliminated from a producer's contract as a condition for the grant of temporary authorization to sell gas, where such provision had previously been included in numerous contracts in the area. The Commission action there was, however, based not on a rule of general applicability promulgated after extensive administrative proceedings, as here, but only on a statement of policy issued without any prior Commission proceedings.[32]

It should also be pointed out that in making this contention petitioner baldly states that the rejected filings were not based on a new contract. But clearly the April 9, 1962, agreement here involved is a new contract. Admittedly, the parties, instead of writing an entirely new document, found it more convenient to incorporate by reference terms of an existing contract between the same parties for gas from adjacent acreage. But since nothing in the incorporated contract required or even contemplated that sales from any additional acreage would have to be made subject to the same terms, petitioner's claim that the so-called supplemental agreement of April 9, 1962, was not, as a matter of law, a new contract is frivolous. And, of course, the labelling of the certificate application as an amendment does not alter the fact that the authority to sell from the new acreage required new certificate authorization pursuant to Section 7(c) and (e) of the Act. *Cf. Montana Power Co.* v. *F.P.C.*, 298 F. 2d 335, 339 (CADC).

[32] Though the *Sohio* case is thus clearly different from the present case, it should be pointed out that the Commission does not believe that the *Sohio* case was properly decided.

IV. The legality of contract clauses in the absence of Commission action does not preclude their prospective elimination

Contrary to petitioner's suggestion (Br. pp. 23–28), cases in which the courts have given effect to rates increased under indefinite escalation clauses in contracts approved by the Commission in certificate cases do not impugn the Commission's power to proscribe such clauses prospectively. For the legality *vel non* of a contract provision as a matter of general law, is not necessarily controlling on the question of its legality under a supervening regulatory scheme—a matter to be administratively determined. See *Southwestern Sugar & Molasses Co.* v. *River Terminals Corp.*, 360 U.S. 411, 416–418; *Pennsylvania Water & Power Co.* v. *F.P.C.*, 343 U.S. 414, 421–423.

Moreover, even if the Commission had previously expressed approval of the provisions now proscribed, the only question for a court in passing on the regulation proscribing them would be to determine if there is presently a reasonable basis for doing so. In *American Trucking Associations, Inc.* v. *United States*, 344 U.S. at 298, where the approved regulations in effect outlawed trip-leasing practices previously approved, the Court observed in this respect (344 U.S. at 314):

> * * * The mere fact that a contrary position was taken during the war years when active interchange and leasing were required, that the Commission has never before restricted trip-leasing and has in fact approved it from time to time, does not change our function. [Footnote omitted.]

But the fact is that the Commission has long regarded indefinite escalation provisions with disfavor. Indeed, from December 17, 1954 (13 F.P.C. 1576, 1584) until amended by Order 242, Section 157.25 of the Commission's regulations under the Natural Gas Act, which relates to producer certificate applications, provided (18 C.F.R. 157.25):

> * * * Escalation clauses in contracts submitted hereunder on or after May 1, 1955, will not be considered in support of any certificate application or otherwise given effect by the Commission if under such clauses: (a)

> provision is made for adjustment of the price of the seller by reason of changes in the prices received by the purchaser upon resale; or (b) if provision is made for adjustment of the price of the seller by reason of the payment of higher prices by other purchasers in the same or other producing areas.

And the proceeding resulting in Order 232 was commenced in April, 1956. As petitioner points out (Br., pp. 26–27), the Commission in its annual reports to Congress from 1956 through 1960, included in its overall recommendations for modifying independent producer regulation a request that such clauses be outlawed in existing as well as future contracts. Thus, the Commission has consistently expressed its view that these clauses are against public policy.[33]

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[33] Petitioner seems to view the Commission's legislative recommendations as support for its position that the Commission may not proceed by regulation. These recommendations were not only part of a package, as we have stated, but by relating to clauses in existing contracts went beyond the Commission's present regulations. Moreover, since the Commission disapproved indefinite escalation provisions, though its rule-making procedures had not been completed, requests for Congressional action similar to existing bills then pending certainly provides no indication that the Commission doubted its authority to proceed on its own. For Congressional proscription of indefinite escalation provisions as part of a package might have avoided the drawn out litigation challenging these regulations.

CONCLUSION

For the reasons stated, the Commission's order should be affirmed.

Respectfully submitted.

RICHARD A. SOLOMON,
General Counsel,

HOWARD E. WAHRENBROCK,
Solicitor,

PETER H. SCHIFF,
Attorney,
For respondent.
Federal Power Commission,
Washington 25, D.C.

MARCH 11, 1963.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

_____,
Attorney.

APPENDIX A

United States of America
Federal Power Commission

Before Commissioners: JEROME K. KUYKENDALL, *Chairman;* FREDERICK STUECK, ARTHUR KLINE and PAUL A. SWEENEY

Docket No. R–153

NONACCEPTABILITY OF CONTRACTS BETWEEN PRODUCERS AND INTERSTATE NATURAL-GAS COMPANIES CONTAINING CERTAIN TYPES OF AUTOMATIC ESCALATION AND FAVORED NATION CLAUSES

(18 CFR 154.91(a) and 154.93)

ORDER No. 232

Amending the Commission's General Rules and Regulations

(Issued March 3, 1961)

In this proceeding, the Commission has under consideration a proposed amendment of § 154.93 of its General Rules and Regulations (18 CFR 154.93) respecting the filing of rate schedules containing certain provisions for adjustments in the price of the seller, e.g., "favored-nation", "redetermination", and "spiral escalation" clauses.

General public notice of this proposed rule-making was given by publication in the Federal Register on April 12, 1956 (21 FR 2388) and mailing notices to interested parties, including State and Federal regulatory agencies.[1]

[1] This issue was also fully tried, briefed, and argued before the Commission in *The Pure Oil Company*, Docket No. G–17930, in which decision is being issued this day.

In response to such notice, numerous suggestions and comments were submitted by interested parties respecting the changes in the Commission's rules therein proposed. All such suggestions and comments have been carefully considered, but, for reasons set forth in our findings, we adhere to the rule as originally proposed with certain changes made thereto.

The Commission finds:

(1) The natural gas industry and natural gas service are aided and developed by the use of long-term contracts for the sale of natural gas by producers to pipeline companies or to others, and it is desirable and appropriate in the public interest that long-term contracts be utilized as a basis for considerations of supply and service expansions by natural gas companies.

(2) Long-term gas supply contracts containing provisions for rate changes dependent or based in part on "indefinite escalation clauses", as herein defined, have contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies. As found by us in the proceeding of *The Pure Oil Company,* Docket No. G–17930, Opinion No. 341 issued concurrently herewith, these indefinite escalation provisions are contrary to the public interest. Such escalation provisions, therefore, are undesirable, unnecessary, and incompatible with the public interest for the due and proper development of natural gas service by natural gas companies.

(3) It is necessary and appropriate in the public interest and in the proper administration of the Natural Gas Act that § 154.91(a) of our General Rules and Regulations (18 CFR 154.91(a)) be amended to include definitions of "definite escalation clause" and "indefinite escalation clause" to define clearly the amendment necessitated by our findings in subparagraph (2) hereof.

The Commission, acting pursuant to authority granted by the Natural Gas Act, particularly Sections 4, 7, and 16 thereof (15 U.S.C. 717c, 717f, and 717o), *orders:*

(A) Part 154, entitled Rate Schedules and Tariffs and Subchapter E—Regulations Under Natural Gas Act, Chapter I of Title 18, Code of Federal Regulations, is amended as follows:

(1) In § 154.91(a), change the caption "Definition" to read *"Definitions (1)"* and adding subparagraphs (2) and (3) to read:

"(2) 'Definite escalation clause' means any provision in an independent producer's contract for the sale of natural gas in interstate commerce for resale or the transportation of natural gas in interstate commerce which sets forth the price to be paid for natural gas delivered thereunder in terms of a specific price per unit, including, in addition to the initial price, any increases therein by specific amounts at definite future dates, or any provision which changes the specific price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller.

"(3) 'Indefinite escalation clause' means any provision, other than a definite escalation clause as defined in subparagraph (2) hereof, under which the price in a contract for the sale or transportation of natural gas by an independent producer subject to the jurisdiction of the Commission may be determined or changed."

(2) Adding a proviso at the end of § 154.93, *Rate schedule defined,* to read as follows:

"Provided, That any provision for a change of price of the seller by reason of indefinite escalation clauses, as defined in § 154.91(a)(3), contained in a contract for the sale or transportation of natural gas subject to the jurisdiction of the Commission tendered for filing on and after April 3, 1961, shall be inoperative and of no effect at law."

(B) These amendments shall become effective April 3, 1961. Any interested person may submit to the Commission on or before March 20, 1961, views or comments in writing concerning these amendments.

(C) The Secretary of the Commission shall cause publication of this order to be made in the Federal Register.

By the Commission. Commissioner Kline, concurring in part and dissenting in part, filed a separate statement.

[SEAL] JOSEPH H. GUTRIDE, *Secretary.*

KLINE, Commissioner, *concurring* in part and *dissenting* part

I concur completely in the rule insofar as it renders void and inoperative favored nation, spiral escalation and price redetermination clauses in future contracts. I feel such clauses are definitely contrary to the public interest when appearing is gas contracts subject to our regulation.

I am opposed to the rule insofar as it renders void and inoperative provisions in producer contracts permitting price changes arrived at through negotiation or arbitration after a period of five years from the date of the contract. The broad definition of the term "indefinite escalation clause" contained in the rule would eliminate these as well as other unspecified contractual provisions.

It is the practice in the industry for producers to enter into long term contracts for the sale of gas. Such contracts usually run for twenty years or the life of the field which may be fifty or more years. The Commission encourages such long term contracts and this order itself contains a finding that they are in the public interest. It is impossible for anyone to predict with accuracy the economic conditions so far in the future, what the costs of a producer will be at that time, or what will constitute a just and reasonable price for gas. Yet under the law a natural gas company is bound by its contract and may not unilaterally file for increased rates. *United Gas Pipe Line Co.* vs. *Memphis,* 358 U.S. 103; *United Gas Pipe Line Co.* vs. *Mobile,* 350 U.S. 322. Under such circumstances a producer should have a contractual right to renegotiate his contract price at some time in the future in order to protect himself against inflation or other unforeseen contingencies. He should not be compelled to agree at the beginning of his contract to a fixed price for the gas twenty or fifty years in the future, when conditions may be wholly different.

Many producers have already substituted such negotiation and arbitration clauses in their contracts in lieu of the favored nation and spiral escalation clauses. We have never had a hearing on the issue of whether such provisions are contrary to the public interest, the majority has failed to give any reason for outlawing them, and I can see no reason why we should not permit them.

A contract providing for re-negotiation of the price at some future date, and for arbitration in event the parties fail to agree, merely gives the producer the right to file for such price. The Commission will, of course, disallow it in event it is not a just and reasonable price. Since the gas is already committed to the pipeline, the producer will not have any distinct bargaining advantage. If anything, he will be at a disadvantage, and I see no reason to fear that excessive prices will result, even during the temporary suspension period, as a result of a negotiation and arbitration clause.

I appreciate the difficulty we have in stabilizing gas prices and I would have no objection to a rule finding that it is in the public interest to eliminate even the right to negotiate for a period during which we can reasonably expect economic conditions not to undergo too radical a change, such as a five year period.

In the *Memphis* case, *supra*, the Supreme Court sustained the contention of this Commission that a natural gas company should have the contractual right to file for an increase even though the amount of the increase is not specifically stated in the contract. We cannot arbitrarily abolish that right but can do so only if the contractual provision supplying the right is against the public interest.

Finally, the adoption of such a broad rule seems to me to be extremely short sighted. Once a rule such as this is adopted, the average businessman, as a matter of self preservation, will seek to avoid its effects. Here the producer will undoubtedly seek to protect himself by increasing the initial price or providing for steeper escalations or through some other means. We impliedly put our blessing on definite escalation clauses regardless of the amount. I consider a contract provision calling for a five cent escalation every five years far worse than a contract provision calling for a one cent escalation with the additional provision for negotiations. Yet the adoption of such a rule as this cannot help but lead to some such results.

In summary, I am opposed to the rule as written because we have never published notice of any intention to adopt such a rule, no showing has been made that all outlawed clauses are

against the public interest, and I believe a producer should not be required at his peril to attempt to set prices twenty years in the future, but should be afforded some reasonable means of negotiating a price at a time when he knows the conditions with which he will be faced.

ARTHUR KLINE, *Commissioner.*

APPENDIX B

United States of America
Federal Power Commission

(Received, May 4, 1956)

Docket R–153

NON-ACCEPTABILITY OF CONTRACTS BETWEEN PRODUCERS AND INTERSTATE NATURAL GAS COMPANIES CONTAINING CERTAIN TYPES OF AUTOMATIC ESCALATION AND FAVORED NATION CLAUSES

Protest of The Superior Oil Company

Now comes The Superior Oil Company, called hereinafter "Superior", a corporation organized under the laws of the State of California, with a principal place of business at 400 Oil & Gas Building, Houston 2, Texas, in response to notice concerning the above matter involving a proposal to amend Part 154 entitled "Rate Schedules and Tariffs of Sub-Chapter E, Regulations Under the Natural Gas Act, Chapter 1 of Title 18, Code of Federal Regulations." Superior is an independent producer within the definition thereof in Section 154.91 of Commission Order No. 174–B, although the validity of such order and the legality of its application to Superior is expressly denied. Subject to said denial Superior submits this protest to said proposed rule.

I

Basically Superior opposes this rule on the following several grounds:

(1) The proposed rule would violate the Fifth Amendment of the Constitution of the United States protecting the liberty and freedom of contract.

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(2) The proposed rule is beyond the authority of the Federal Power Commission as delegated by the Natural Gas Act.

(3) The proposed rule would cause irreparable damage to independent producers required to comply therewith during the period of time following its adoption and the time it could be judicially considered and condemned.

(4) No rule should now be adopted which will affect the sale of natural gas by independent producers for a long period of time regardless of changes in the Natural Gas Act, or its interpretation, in view of the congressional dissatisfaction with said Act as evidenced by the "Kerr Bill" [1] and the "Harris Bill",[2] which have failed of becoming law only by reason of presidential vetoes, and particularly since the last veto message recognized the need for amendment of said Act.

II

The right of independent producers and their vendees to provide for future prices on any basis that said parties mutually deem proper is protected by the Fifth Amendment to the Constitution.[3] While such freedom is not absolute, "* * * freedom of contract is, nevertheless, the general rule and restraint the exception * * * justified only by the existence of exceptional circumstances." [4] The purchaser requires stability of supply of natural gas and recognizes the market price of such gas will be influenced by the law of supply and demand, the forces of inflation, and other economic factors which will fluctuate during any period of years. The producer not only wants the fair market price for his product at the inception of the sale, but so long as the sale continues, and is often legally obligated to

[1] The Kerr Bill, S. 1498, 81st Congress, 1st Session.

[2] The Harris Bill, H.R. 6645, 84th Congress, and Veto Message February 17, 1956.

[3] *Adkins* v. *Childrens Hospital*, 261 U.S. 525, 43 Sup. Ct. 394; 67 L. Ed. 785. "That the right to contract about one's affairs is a part of the liberty of the individual protected by this (due process clause of the Fifth Amendment) clause is settled by the decision of this Court and is longer open to question.

[4] *Adkins* case, *supra*.

his royalty owners to pay such price at all times. The Commission has heretofore adopted Order 174–B which effectively prevents the *operation* and *consideration* of contract clauses of the general type it now proposes to proscribe. Without arguing at this time the propriety of Order 174–B (which prohibits the automatic operation of such clauses and eliminates their consideration), it is obvious that the Commission has found a method to fully protect what it deems to be the public interest without condemning a whole contract or attempting to write a contract for the parties. To provide that no contract may include such a clause, which is the effect of the proposed order, is an arbitrary and unreasonable infringement of the liberty of contract not required for protection of the public interest.

III

The proposed rule is completely beyond the authority of the Federal Power Commission. The recent decision by the Supreme Court in the "United" case [5] interpreting the Natural Gas Act clearly so holds. It was there said: "The basic power of the Commission is neither one of 'rate making' nor 'rate changing' but merely to set aside and modify any rates or contracts found after hearing to be unjust * * * ", etc. If, as was said in that case, the Natural Gas Act permits the relationship between the parties to be established initially by contract, subject to review by the Commission in connection with the protection of the public interest, it is clearly apparent that the Commission cannot *determine what contracts or what provisions of contracts may or may not be entered into by the parties subject to its jurisdiction.* The sole authority of the Commission is to *review* such contracts and if provisions thereof be found to be not in the public interest, suspend, modify or deny the operation of such provisions. The unfettered right to contract is a necessity under the rule announced in the "Sierra" case.[6] There the Supreme Court held that while the Commission could not

[5] *United Gas Pipe Line Company* v. *Mobile Gas Service Corporation,* decided February 27, 1956, opinion by Justice Harlan reversing Court of Appeals' decision, 215 Fed. 2d, 883, official reporter citation not yet available.

[6] *Federal Power Com.* v. *Sierra Pacific Power Co.,* decided February 27, 1956. Opinion by Justice Harlan on certiorari from decision reported 223 Fed. 2nd 605 (official reporter's citation is not yet available).

fix rates which were unreasonably low it could permit rates to stand which were unreasonably low if the parties had agreed to such rates unless overall financial ability of the company would be so impaired as to hinder continued public service.

IV

The proposed rule will cause irreparable injury to independent producers in many instances, even though said rule is finally declared invalid. Under existing Rule 174–B an independent producer must file with the Commission a rate schedule covering each interstate sale of natural gas. A rate schedule is defined as "the basic contract and all supplements or agreements amendatory thereof." [7] If the proposed rule is adopted the independent producer is faced with a dilemma. He is required to file his sales contract to avoid violation of the Act with resulting penalties provided therein, but the contract may not include provisions which business experience has shown are necessary for his economic protection, are acceptable to his purchaser, and which to date the courts have found to be legal and proper. He is bound by his contract as filed notwithstanding that the Commission rule which prevented him from including such protective provisions in the contract may have been held invalid long before the contract terminates. Nor may the independent producer obtain protection through the process of making only a short term contract for there is grave doubt as to whether a jurisdictional sale once commenced may be discontinued regardless of the expiration of the contract period.[8] Should the proposed rule be adopted, the independent producer is helpless to protect himself in the event the rule is determined to be invalid or is voluntarily repealed by the Commission.

[7] Sec. 154.93, General Rules & Regulations of Federal Power Commission.

[8] Examiner's decision G–3038, et al., October 6, 1955, in *The Matters of J. M. Huber Corporation, et al.*, "Even though Huber, under the provisions of the contract could have terminated it, Huber would not have been relieved from the necessity of meeting the statutory requirements of Sec. 7(b)* * *", etc. *Fed. Power Com.* v. *J. M. Huber Corp.*, 133 F. Supp. 479. In the Matters of *Dixie Pipe Line Co., et al.*, G–2041, et al., Commission Opinion No. 285, Sept. 9, 1955.

V

The proposed rule to exclude whole contracts if they include particular clauses is wholly unrealistic, unfair and unreasonable. The scope of regulation of independent producers by the Federal Power Commission is presently undetermined. In view of congressional efforts to amend the Natural Gas Act,[9] it is reasonable to assume that the jurisdiction of the Commission over rates and charges of independent producers will be changed by changes in the basic Act. This is particularly true since the last congressional effort to amend the Act failed by reason of presidential veto, yet the veto message proclaimed the amendment of the Act to be meritorious and in the national interest.[10] To adopt rules at this time requiring or prohibiting provisions of long term contracts is arbitrary and an abuse of power. Certainly all contracts are subject to valid provisions of the Natural Gas Act since no one can validly contract contrary to law. Order No. 174–B which provides that "no consideration" shall be given to certain clauses is based on such rule and is a proper *type* of regulation to announce the policy decisions of the Commission concerning such clauses. To go further and specify what the contract shall provide is going beyond the realm of law enforcement. Even the courts cannot do this.

Wherefore, it is urged that the proposed amendment to Rule 154.93 as set forth in Docket R–153 be found against the public interest, contrary to law, and therefore be rejected.

Respectfully,

THE SUPERIOR OIL COMPANY,
By: H. W. VARNER,
Its Attorney,
Houston, Texas, April 30, 1956.

Of Counsel:
W. B. WAGNER,
H. W. VARNER,
400 Oil & Gas Bldg.,
Houston 2, Texas.

[9] The Kerr & Harris Bills, supra.

[10] "At the same time, I must make quite clear that legislation conforming to the basic objectives of H.R. 6645 is needed." Veto message February 17, 1956. U.S. Code Congressional and Administrative News, 84th Congress, 2nd Session, 1956, No. 3, Page 729.

APPENDIX C

United States of America
Federal Power Commission

(Received, November 13, 1961)

Docket No. R–203

IN THE MATTER OF REJECTING OF SALES CONTRACTS CONTAINING INDEFINITE ESCALATION CLAUSES AND OF ALL APPLICATIONS RELYING UPON SUCH CONTRACTS FOR GAS SUPPLY

Views and Comments of The Superior Oil Company

Comes now The Superior Oil Company ("Superior") and pursuant to Notice of Proposed Rule Making issued in Docket No. R–203 on October 10, 1961, submits its views and comments with respect to the proposed amendments to the Federal Power Commission's ("Commission") Regulations under the Natural Gas Act ("Regulations"). As Superior is classified by the Federal Power Commission as an "independent producer", Superior limits its comments to the proposed amendment to Sections 154.93 and 157.25 of the Regulations. However, these comments are equally applicable to the remaining sections referred to in the Notice.

Superior believes the proposed amendments to the Regulations are unlawful and exceed the powers granted to the Commission under the Natural Gas Act; contrary to the public interest; unnecessary and prematurely proposed; and arbitrary, unreasonably and discriminatory.

The proposed rule changes will drastically curtail the initial rate-making rights of independent producers in a manner never intented by Congress under the Natural Gas Act.

The Commission is given no jurisdiction or power to review contracts, as such, except the power provided by Section 5(a) of the Act, i.e., "to set aside and modify any rate or contract

which it determines, after hearing, to be 'unjust, unreasonable, unduly discriminatory or preferential' ".[1] This is not a power to make rates or dictate contract terms, it "is simply the power to review rates and contracts made in the first instance by natural gas companies".[2] Moreover, by the express language of the statute the power may only be exercised after hearing.

"The limitation imposed on natural gas companies" with regard to contracts "are set out in Sections 4(c) and 4(d)" of the Act. The basic duties are the filing requirements: "Section 4(c) requires schedules showing all rates and contracts in force to be filed with the Commission and Section 4(d) requires all changes in such schedules likewise to be filed".[3] "In short, the [Natural Gas] Act provides no 'procedure' either for making or changing rates" or rate contracts.[4] The "rate-making [and contract-making] powers of natural gas companies [under the Act] were to be no different from those they would possess in the absence of the Act: to establish ex parte, and change at will, the rates offered to prospective customers; or to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer. * * * [The] initial rate-making and rate-changing powers of natural gas companies remain undefined and unaffected by the Act".[5]

In its *Mobile* decision the Supreme Court emphasized as set forth above that natural gas companies have the power "to establish *ex parte*, and change at will, the rates offered to prospective customers." [6] The proposed rule, if it be construed to deny the right to make the Memphis [7] type filings, requires natural gas companies to contract away the right "to change" at will (subject to the Commission's powers of review) the rates at which it will provide natural gas. While the Supreme Court recognizes that a natural gas company may agree by contract not to make *ex parte* changes in rates, the Court's language

[1] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), at 341.

[2] See Fn. 1, *supra*, at 341.

[3] See Fn. 1, *supra*, at 341 and 342.

[4] See Fn. 1, *supra*, at 343.

[5] See Fn. 1, *supra*, at 343.

[6] See Fn. 1, *supra*, at 341.

[7] *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division*, 358 U.S. 103 (1958).

clearly shows the Natural Gas Act did not affect the fundamental right of natural gas companies to file *ex parte* changes in their rates, nor did it accord the Commission the arbitrary right to void such right as the Commission rule would do if not set aside. In its *Memphis* [8] decision the Supreme Court pointed out that "united, like the seller of an unregulated commodity, has the right in the first instance to change its rates as it will, unless it has undertaken by contract not to do so".[9]

The rule change proposed in Docket No. R–203 overlaps what may be found to be the unlawful action taken by the Commission in Order No. 232A, issued March 31, 1961. Validity of Order No. 232A is presently in litigation,[10] and may well be litigated in other forums before the extent of the Commission's interdictive power over the [sic]

If, either in the Sun Oil Company litigation or in the case of an actual implementation of Order No. 232A, the Commission's attempt to outlaw indefinite pricing arrangements will be held invalid, the proposed rule change would be equally unlawful. In the meantime, application of the proposed rule change will irreparably damage countless producers who will be precluded from filing contracts containing indefinite pricing provisions. In the premises the only possible purpose and effect of the proposed rule change is temporarily to close any avenue of escape which might be available to gas producers in the event Order No. 232A is invalidated. Surely, this is an injustice.

The proposed rule change is clearly discriminitary in that it imposes upon natural gas companies which are independent producers entirely different standards than those under which natural gas companies which are pipelines or distributors must operate. In prescribing the types of pricing provisions which

[8] *Ibid.*

[9] See Fn. 7, *supra.*

[10] See Fn. 7, *supra.*

Order No. 232A outlaws indefinite price escalation provisions by rendering "inoperative and of no effect at law" any price increase provision in contracts executed after April 3, 1961, at variance with the types specified in the order. The types permitted are: provisions for reimbursement of changes taxed upon the seller; provisions for definite increases upon definite dates; and provisions for price redetermination based upon Commission approved prices at five-year intervals during which there is no definite increase. (*Sun Oil Company* v. *F.P.C.* No. 19, 001 5th Cir.)

will be allowed independent producers, the Commission proscribes all other pricing arrangements, including that arrangement which is most commonly used by other classes of natural gas companies, the tariff. Under the tariff system, a pipeline company can file for a rate increase of any magnitude at any time, subject only to the limitations of Section 4(e) of the Act. It is clearly discriminatory to allow such provisions in the contracts of one class of natural gas company, while forbidding it in the contracts of another. For such reason, the proposed rule change is arbitrary, unreasonable, and violates the rights of independent producers by confiscating a valuable property right without due process of law. The Commission has indicated that it does not believe that the prohibition placed upon indefinite pricing provisions in any manner limits the rights of independent producers to freely contract the sale of natural gas. The Commission's position as stated in the staff's brief in the *Sun Oil* case [11] is that an independent producer who seeks to utilize a pricing clause prohibited by the Order might either apply to the Commission under Section 1.7(b) of the Regulations for a repeal of the rule or, in the alternative, enter into a short-term contract which would ultimately convert to a tariff arrangement at the end of the primary term. It is obvious that these are not alternatives at all and provide a completely unrealistic approach to the problems faced by the independent producers. In the first instance, if the Commission fails to act upon the motion for repeal of the rule, the proponent of such change is completely without a remedy. With regard to the latter proposal, contracting for the purchase and sale of natural gas is a two-way street. Long term contracts, price considerations aside, are equally for the protection of buyer and seller and insure the seller that the gas produced during the declining period of production, where the seller has limited flexibility, will find a market.

Under the indefinite pricing clauses proscribed by the Commission's Regulations, the pipeline purchaser has it within his power to control the triggering of indefinite pricing provisons. Under the proposal made by the staff for a short-term con-

[11] See Fn. 10, *supra*.

tract followed by a tariff, the pipeline companies would have no control over producer filings whatsover.

In the absence of the right to make contracts with indefinite pricing provisions, the producers are left at their peril to attempt to set prices for many years in the future, a task no producer would undertake willingly. In summation, the proposed rule changes must not prohibit the natural gas companies from "increasing the prices of their product whenever it is economically necessary [as a] means of keeping the intake and outgo of their revenue in proper balance, * * *." [12]

The changes proposed by the Commission, as well as those adopted by the Commission's Order of March 31, 1961, Order No. 232A, are contrary to the public interest and patently unnecessary. The Commission, if it intends to seek the elimination of indefinite pricing provisions, could have accomplished its purpose by a statement of general policy similar to 61–1. This would have advised the independent producers that if they proposed such provisions in any contracts they must show the particular set of circumstances requiring such a provision. This would allow the producers to justify their proposed indefinite pricing provisions on a proper record and would allow the producers a route to appeal to the courts for relief if they believed the Commission's decision erroneous. If the Commission believed such provisions so vitiated the contract as to make it not in the public interest, the Commission clearly has the power under the Natural Gas Act to deny a Certificate of Public Convenience and Necessity to the independent producer.

WHEREFORE, The Superior Oil Company opposes adoption of the rule change as proposed and requests that the Commission defer action with respect to the proposal until such time as the validity of Order 232A is determined.

THE SUPERIOR OIL COMPANY,
By: HOMER J. PENN, *Attorney.*

NOVEMBER 10, 1961.

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[12] See Fn. 7, at 103.

APPENDIX D

United States of America
Before the Federal Power Commission

(Received March 8, 1962)

Docket No. R–203

REJECTION OF SALES CONTRACTS CONTAINING INDEFINITE ESCALATION CLAUSES AND OF ALL APPLICATIONS RELYING UPON SUCH CONTRACTS FOR GAS SUPPLY

Petition for Rehearing of The Superior Oil Company

Comes now The Superior Oil Company (Superior), under the provisions of Section 19(a) of the Natural Gas Act (15 U.S.C. Sec. 717r(a)), called herein "the Act, and files this application and petition for rehearing of Order Number 242 which was issued in the captioned docket on February 8, 1962, and would show to the Commission as follows:

1. Superior has a number of gas sales contracts with favored nation clauses and other "price changing provisions" other than those defined as permissible in the subject order. Superior contemplates that in the future it will execute and file with the Commission other gas sales contracts containing such provisions, which provisions are in general use in the industry and have been found by experience necessary for industry welfare over a period of many years.

2. In issuing the captioned order the Commission exceeded its statutory power in prescribing the terms of contracts under which a producer may sell its gas. Except as restricted by the express or implied provisions of the Act, a natural gas company possesses the same freedom in respect to the making of contracts which it would have in the absence of the Act. The Act does not grant to or take from natural gas companies their power to provide for rates initially by contract or otherwise, subject to

modification by the Commission after hearing and upon a finding that they are unjust and unreasonable or unlawful. The comprehensive statutory scheme set up by the Act is that the natural gas company *makes* contracts and the Commission reviews such contracts *after* they are made. *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.* (1960), 358 U.S. 103; *Amerada Petroleum Corp.* v. *F.P.C.* (10 Cir. 1961), 293 F. 2d 572; and *Willmut Gas & Oil Co.* v. *F.P.C.* (D.C. Cir. 1961), 294 F. 2d 245. To paraphrase Judge Miller in *Willmut:* The initial rate-making and rate-changing powers of the natural gas companies remain unaffected by the Act. An order or regulation requiring rejection of applications for certificates because the underlying gas sales contract contains a favored nation clause or any type of indeterminate pricing provision would deny to Superior the right to makes its initial contracts, which right the *Mobile* decision pointedly affirms to be in a natural gas company.

Judge Harlan said in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.* (1956), 350 U.S. 332, 341:

> These sections are simply parts of a single statutory scheme under which all rates are established initially by the natural gas companies, by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding that they are unlawful. The Act merely defines the review powers of the Commission and imposes such duties on natural gas companies as are necessary to effectuate those powers; it purports neither to grant nor to define the initial rate-setting powers of natural gas companies.
>
> The powers of the Commission are defined by Secs. 4(e) and 5(a). The basic power of the Commission is that given it by Sec. 5(e) to set aside and modify any rate or contract which it determines, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential". This is neither a "rate-making" nor a "rate-changing" procedure. It is simply the power to review rates and contracts made in the first instance by natural gas companies and, if they are determined to be unlawful, to remedy them * * *.

This Commission Order directly conflicts with the above decision and amounts to a legislative change which is beyond the authority of the Commission.

3. The Commission's Order denies to Superior the right to prove the justness and reasonableness of agreed upon future prices by refusing in advance to accept any contract in which the parties have so agreed with the minor and arbitrary exception commented upon hereinbelow. Under established law Superior as a gas producer subject to the Act cannot even seek an increase in price, regardless of its justness and reasonableness, until it has the contractual consent of the purchaser to pay such price, subject, of course, to Commission's final determination of the lawfulness of such price. The Commission has denied to Superior the right to obtain this contractual consent. The Order recognizes that: "The Natural Gas Act contemplates that prices, to be just and reasonable, be related to economic needs." Yet the Commission by this order denies to Superior the right confirmed to it by the Act itself to seek rate increases when it feels that it can prove the justness and reasonableness of such rates. Since a prerequisite in a producer's increased rate filing is the contractual consent of the buyer, which this order would prevent Superior from obtaining, such order denies to Superior the right to seek rate increases which are or may be fully justified by economic need.

4. The Order denies due process of law to Superior and its purchasers of gas by denying them the right to contractually provide for and consent to prices which they feel should be applicable during the 20-year term of a gas sales contract. The Order recognizes that "the Natural Gas Act contemplates that rate increases shall be sought when there is economic justification * * *", yet it solemnly pre-judges future economic requirements without any basis of fact, or any hearing in which facts relevant thereto might be adduced.

5. The Order is incompatible with the statutory scheme of effective rate regulation which contemplates change, and impliedly precludes the fixing of a permanent price ceiling. The effect of a present determination that any increase in producers' prices in excess of 1¢ per MCF each five (5) years, or a total price increase of 3¢ per MCF during the next twenty (20) years,

without any hearing, or a factual basis is arbitrary on its face. Even the most talented and qualified economic prophet cannot with responsibility now so predict. Certainly such a determination is unreasonable and unlawful when made without a hearing and behind the closed doors of the Commission Chambers.

The Commission Order refers to cases under the Interstate Commerce Act. The difference between the powers of the Interstate Commerce Commission and those of the Federal Power Commission in the fixing of rates has been pointed out in *Mobile, supra,* Page 345. See also *Willmut, supra.* Mere administrative convenience through the elimination of the right to present matters which present problems for determination is no substitute for justice or due process of law.

Premises considered, Superior respectfully urges that a rehearing be granted and that upon reconsideration the Commission rescind its Order No. 242.

Respectfully, submitted,

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In The

United States Court of Appeals

For the Ninth Circuit

No. 18,252

The Superior Oil Company,

Petitioner,

v.

Federal Power Commission,

Respondent.

REPLY BRIEF FOR PETITIONER, THE SUPERIOR OIL COMPANY

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April 1, 1963

BORG PRINTING COMPANY OF TEXAS, HOUSTON, TEXAS

SUBJECT INDEX

INDEX OF AUTHORITIES

Table of Cases:

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No. 18,252

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REPLY BRIEF FOR PETITIONER, THE SUPERIOR OIL COMPANY

The Brief of Respondent herein states that the only issue before this Court is the validity of the Commission's Regulations promulgated in its Order 242 and its antecedent Order 232-A. This presentation of the issue is only partially correct. The full issue here is whether the Federal Power Commission has authority under the Natural Gas Act to reject, by summary action and order of its Secretary, an application for certificate of public convenience and necessity and the related rate schedule which meet all the formal filing requirements for same. The stated basis for such rejection was that the application for certificate of public convenience and necessity and the rate schedule were based on contracts, the provisions of which might permit future changes in price in amounts determinable by future events.

Respondent argues (Brief p. 9) that it has such authority under the Act because its contested orders, and the regulations embodying same, are "reasonable". This argument ignores the primary and fundamental question, *i.e.,* did Congress under the Natural Gas Act delegate such power to the Commission. Only when, as, and if this preliminary question has been answered in the affirmative does the question of "reasonableness" of the Commission's orders, including the matter of supportable findings justifying such orders, become material. The cart-before-the-horse approach of Respondent should not be allowed to obscure the fundamental fact that unless the Natural Gas Act delegates the rule and regulation-making authority contended for by Respondent, such rule and resulting regulation are void.

I.

Somewhat belatedly (Brief, p. 29 et seq.) Respondent does claim authority under the Act for such rule making.[1] The purported authority is first sought under Section 5(a) of the Natural Gas Act. This section[2] permits the Commission to initiate *a hearing* to *determine* whether any rate, charge, or classification *then being charged* by a natural gas company, or any rule, regulation, practice, or contract *affecting* same is unjust, unreasonable, unduly discriminatory or preferential, and, *if so,* to fix by order the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed. Respondent argues that since this section permits contracts affecting existing rates to be modified *after a hearing,* its authority to issue rules of general applicability providing what contracts may and may not provide is clear. Certainly natural gas companies' contracts are

[1] See Petitioner's Brief, p. 8-18, 26-27 and 30-42 on lack of such authority.
[2] Section 5(a) is quoted in full in Petitioner's Brief p. 3a-4a.

subject to Commission review and possible revision under this section, but *only after a hearing* instituted to determine whether such rates are unjust, unreasonable, unduly discriminatory, or preferential, and *only after a finding* of the Commission, *supported by substantial evidence* presented in that hearing, that such rate, charge, and classification *are in fact* unjust, unreasonable, unduly discriminatory, or preferential.[3]

Respondent also relies on Section 4(e) which authorizes the Commission *after a hearing* to consider the justness and reasonableness of *changed rates*.[4] Neither Section 4(e) nor 5(a) gives any support to Order 242[5] which promulgates the Regulations of the Commission relied upon herein.[6] Said Order and Regulations have application neither to *existing* nor *changed* rates to which Sections 4(e) and 5(a) are limited. The Order applies to new contracts and amendments which of necessity set initial or unchanged rates.

The need to construe these sections no longer exists. Judicial limitation on Commission authority under these sections is clear. Without equivocation it denies the sought-for authority of the Commission. In *Mobile*[7] the Supreme Court found that the Natural Gas Act evinces no purpose to abrogate private contracts as such (p. 338); that the public interest is served by permitting the relations between the parties to a gas sale agreement to be established

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[3] The necessity for a hearing is covered in Petitioner's Brief, p. 8-18. 30, 35 and 36-41. See also: *Colorado-Wyoming Gas Co.* v. *FPC* (1945) 324 U.S. 626, 634, 65 S. Ct. 850; *U.S.* v. *Carolina Freight Carriers Corp.* (1942) 315 U.S 475, 488-489, 62 S. Ct. 722; and *Braniff Airways, Inc.* v. *CAB* (C.A.D.C., 1962) 306 F. 2d 739, 742-743.

[4] Section 4 is quoted in full in Petitioner's Brief, p. 1a-3a. Section 4(e) is at p. 2a.

[5] Petitioner's Brief, p. 13a-16a.

[6] R. 121.

[7] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, (1956) 350 U.S. 332, 76 S. Ct. 373. See Petitioner's Brief, p. 13-17, 20, 26, 35, 40, 47 and 52.

initially by contract (p. 339); and that the Act neither grants nor defines the initial rate-setting powers of natural gas companies (p. 340). The filing of a change in rate schedule under Section 4 does not institute a proceeding to review; such a proceeding can only be instituted by the Commission itself under Section 4(e) (p. 342). The Act presumes the capacity of natural gas companies to make and change rates and contracts, subject only to being set aside if found unlawful after a hearing instituted by the Commission: "The initial rate making and rate changing powers of natural gas companies remain undefined and unaffected by the Act." (p. 343)

In *Memphis*[8] the Act was again construed. Congressional concern "for the legitimate interests of natural gas companies in whose financial stability the gas-consuming public has a vital stake" was recognized and the Court said further:

> "Business reality demands that *natural gas companies should not be precluded by law from increasing the prices of their product* whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance * * *." (p. 113) (Emphasis added.)

And:

> "What has been said disposes of the question whether *anything* in the Natural Gas Act forbids a seller to change its rates pursuant to Section 4 procedures * * *" (p. 114) (Emphasis added.)

If natural gas companies *by law* should not be precluded from increasing their prices, and were not so precluded by the Natural Gas Act, a rule which does preclude this is clearly beyond the Act and cannot be adopted as necessary to carry out the provisions of the Act. The rule which prohibits contractual consent to a rate change precludes a

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[8] *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division* (1958), 358 U.S. 103, 79 S. Ct. 194. See Petitioner's Brief, p. 17-18, 25-26 and 39-40.

change, for under *Mobile, supra,* if there is a contract, changes not provided for therein cannot be sought by the seller. Respondent says it does not have to *tolerate* contracts which may hamper its regulations. This is tantamount to saying it does not have to regulate under the Natural Gas Act as enacted by Congress but may re-write that Act as it sees fit. (See Petitioner's Brief, p. 40-41)

In *Willmut Gas & Oil Co.* v. *Federal Power Commission,* (C.A. D.C., 1961), 294 Fed. 2d 245, 250-251, cert. den. 368 U.S. 975, 82 S. Ct. 477, it was held that a natural gas company's rate-making and rate-changing power was such that the Commission may not refuse to file a tendered new schedule showing changes in rates, nor summarily reject or disallow the new schedule without a hearing. *Mississippi River Fuel Corp.* v. *Federal Power Commission,* (C.A. 3, 1953), 202 Fed. 2d 899, 900-903, writ dismissed 345 U.S. 988, 73 S. Ct. 1138, held the same thing. (Petitioner's Brief, pp. 9-13).

Respondent also relies on Section 7 of the Act for authority to make the regulations promulgated in its Order No. 242. This is equally lacking in merit. In *Texaco, Inc.* v. *Federal Power Commission,* (C.A. 5, 1961), 290 Fed. 2d 149, dealing with a situation where under Section 7(e) the Commission, after a hearing, had found that a reduction in the initial price of the producers' contracts was required in the public interest, the Court sustained the initial price reduction but specifically held that conditioning authority under Section 7 cannot limit the producers' right to file for the contractually established price (p. 156). In other words, modification by the Commission under its conditioning authority in a certificate proceeding does not *change* or *alter* the contractual relations *between the parties* and there is "no authority for holding that a producer does not have the right immediately to file" an increase in rates. This has

also been held most recently by the same Court in *H. L. Hunt et al.,* v. *Federal Power Commission,* (C.A. 5, 1962), 306 Fed. 2d 334, rehearing pending. There, in issuing a temporary certificate under Section 7(c) the Commission had inserted a condition, the effect of which was to preclude future price increases without express Commission approval.[9] Striking down such condition the Court said:

> "We hold that the Commission may not thus effectually condition-out a statutory right which Congress has prescribed." (p. 335-336).

The Court regarded the attempted condition as one having potential "awesome" consequences, thus:

> " * * * if the Commission may set aside Section 4 and the rights, privileges, and protections which it accords to a natural gas company subject to all of the obligations of the Act, then there is no end to the legislative tampering which the Commission may undertake." (p. 344).

The effect of Order 242 permitting the Commission's Secretary to reject applications for certificates of public convenience and necessity and rate schedules without a hearing (because of their substance) is almost exactly what *Mississippi River Fuel Corp.* v. *Federal Power Commission, supra,* held the Commission had no authority to do. It was there held that because of its quasi-judicial nature the Commission might expeditiously employ some form of summary dismissal procedure but it could not do so under the present Act, *i.e.*

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[9] There is no issue here of whether Sections 4, 5 or 7 of the Act "curtail" the authority of the FPC under Section 16. (Respondent's Brief, p. 36 et seq.) The issue here is whether the authorities granted in those Sections of the Act for dealing with rates and certificates in specific manners provide the basis here claimed by FPC for the exercise of its rule-making power under Section 16 as has been done here. The Courts have held that they do not. (Petitioner's Brief, p. 9-13, 34-42).

> "But the statute which defines the powers of the Commission in natural gas matters makes no provision for any such procedures." (p. 902).

As pointed out in Petitioner's original Brief (p. 26-27), the Commission has heretofore recognized its lack of statutory authority to do just what it now proposes to do by rule. In its 36th Annual Report to Congress (1956), the Commission requested that Congress enlarge its authority by amending the Act to proscribe indefinite pricing clauses. The specific recommendation is quoted in Petitioner's original Brief (p. 26-27), and the effect of Congress' failure to act thereon is there discussed. Notwithstanding such request and its reiteration in each subsequent Annual Report to Congress through 1960, Congress has failed to grant such request. The Commission's most recent Annual Report to Congress (1962, p. 16) recognizes again its lack of authority to issue Order 242 by conceding that Section 7(c) mandatorily requires a hearing on all applications for certificates. That request was:

> "10. *Notice and opportunity for hearing in certificate cases.* — Amend Section 7(c) to eliminate the mandatory hearing requirement, substituting in lieu thereof a provision for due notice and opportunity for hearing."

In the light of these admissions by the Commission, it seems frivolous for Respondent to here contend that the Act, without the requested amendments by Congress, permits a rule which does proscribe indefinite escalation provisions and does eliminate the mandatory hearing requirements of Section 7(c). It is noteworthy that this last Report to Congress was made at the conclusion of the Commission's fiscal year operations terminating June 30, 1962, and after its promulgation of Order 242.

II.

The Commission orders and the regulations flowing therefrom must be tested by this Court in the light of the reasons substantiating them announced by the Commission in adopting such orders. *Securities & Exchange Commission* v. *Chenery Corp.* (1942), 318 U.S. 80, 63 S. Ct. 454. In connection with Order 232 the Commission found that "indefinite escalation clauses" as defined have contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies (Respondent's Brief, p. 50). In its Order 232-A the above finding in Order 232 was reiterated along with the statement that indefinite escalation provisions are in general contrary to the public interest (Petitioner's Brief, p. 18a). In Order 242 (Petitioner's Brief, p. 13a-16a) the Commission found, that as held by it in the *Pure Oil Company* case, 25 FPC 383, indefinite escalation clauses are contrary to the public interest and that increases in producer prices triggered by indefinite escalation clauses have resulted in a flood of almost simultaneous filings. That such filings bear no apparent relationship to the economic requirements of the producers who file them, but that the Natural Gas Act contemplates that prices to be just and reasonable be related to economic need. That filings under indefinite escalation clauses have created a significant portion of the administrative burden under which the Commission is laboring, and that the complexity of indefinite price clauses requires the Commission to spend an undue amount of time in their interpretation and application. "Accordingly, in protecting the public against waves of increases which have no defensible basis, we also serve the need — which we believe we should take into account — of making the task of regulation more manageable."

Significantly, and for the reason that there was no evidentiary hearing, the Commission submits nothing but conclusions of its own for the justification of these orders. Its *ipse dixit* alone is offered for consideration by the reviewing court. This is totally insufficient for, as said in *Burlington Truck Lines, Inc.* v. *United States* (1962), ... U.S. ..., 83 S. Ct. 239, 245:

> "Expert discretion is the life blood of the administrative process, but 'unless we make the requirements for administrative action strict and demanding, expertise, the strength of modern government, can become a monster which rules with no practical limits on its discretion.' * * * *The agency must make findings that support its decision, and those findings must be supported by substantial evidence.*" (Emphasis added)

It is noteworthy that the only evidentiary basis even referred to in the orders is that based upon the record in the *Pure Oil Company Docket G-17930,* Opinion 341. Superior was not a party to that proceeding and under established law is not bound by the record in that case. As pointed out in our original Brief (p. 9-14, 30-34) the application of that record to this proceeding would totally deprive Superior of due process of law for it would have no opportunity to cross-examine or rebut the evidence there presented.

Over and above the fact that if evidence had been allowed, and the usual quasi-judicial process of examination, cross-examination, and rebuttal permitted, the "findings" of the Commission would have been shown wholly unsupportable, the findings and order are inconsistent within themselves:

First, the Commission finds that indefinite pricing clauses are contrary to public interest but then prescribes such a clause in Section (c) of Section 154.93 (R. 121).

Second, the Commission finds that there must be economic justification for rate increases to be *filed*, but as pointed out in Respondent's Brief (p. 15-16), the rule would not proscribe any number of fixed escalations nor limit the amount of such escalations. Certainly there is no economic justification for price increases of 5¢ per MCF every 1, 2, 3, or 4 years. Yet, this is permitted. Moreover, economic justification for a FILING is not required by the Act. There is a clear distinction between what is required by the Act to *make* an increased rate filing, and what is required to *sustain* that filing if it is suspended and hearing called to determine its "justness and reasonableness". The ONLY restriction on *filing* under the Act is whatever *contract* restriction is undertaken by the parties as disclosed by the authorities cited in I, *supra*.

Third, the Commission says that indefinite pricing provisions contribute to instability of prices and service expansion. What could lead to greater instability of prices than annual and large increased filings. It is most significant that the pipe line and distribution industries have grown from relative insignificance to towering giants, employing indefinite pricing provisions as an adjunct to fixed price escalations and relying upon producer contracts containing such provisions. The hard facts of experience cannot be overcome by administrative expertise.

Fourth, the Commission says it has been over-burdened by rate increase filings, a significant portion of which result from flexible pricing. If flexible pricing is to be eliminated, and as shown hereinafter that permitted by Sec. 154.93(c) is of no protection, then the suggestion of Respondent (Br. p. 16) that a producer should bargain for higher and more frequent periodic increases, will do nothing to alleviate the burden. Moreover, "Arguments

that tribunals are too busy to do their duty (citation omitted) or that it is more expeditious not to recognize rights, are not agreeable ones." *NLRB* v. *Trancoa Chemical Corp.* (C.A. 1, 1962), 303 Fed. 2d 456, 461-462. See *LaBuy* v. *Howes Leather Co.* (1957) 352 U.S. 249, 259, 77 S. Ct. 309.

The Commission also says that the flexible pricing provisions are too complex and unduly burden it. Every agency must face threshold questions concerning its jurisdiction. Neither rule nor regulation can eliminate this. Superior's contracts cited in Respondent's brief (p. 8) belie Respondent's contention. The price redetermination clause requires agreement of the contracting parties personally or as the result of arbitration. This places no burden on Respondent at all. The favored nation clause requires only a comparison of gas and conditions. This, in the light of Respondent's claimed expertise and experience, seems relatively simple.

III.

Respondent's Brief would further justify these orders on the ground that they are reasonable. Reasonable with reference to what? The order would purportedly promote the stability and certainty of prices of gas and, yet, according to Respondent's Brief, the order does not proscribe short term contracts nor any number of definite price increases, nor the amount of definite increases. (Respondent's Brief, p. 15-16). If this is true, price uncertainty is increased by the order rather than decreased. In any event whether price certainty and stability of supply is increased or not, the substantial question and issue of fact concerning this can be properly determined only on the basis of evidence presented.

Respondent's Brief (Page 17) points out that in the light of Order 242 companies are much more able to project, even over a 20-year contract period, what specific escalations would be needed to file for rates the Commission would approve. Substantiation for that statement is to be found only in counsel's words. Moreover, prediction as to what rates the Commission will approve is less certain than predictions based upon the stars. The Commission has indicated no standard for determining the justness and reasonableness for determining any rate increase.[10] Moreover, as recently as February 4, 1963, the Commission suspended for the full five months period 39 rate increases, all based on fixed escalation provisions, and all below the Commission's stated applicable area prices, *Mills Bennett Estate,* Docket RI63-308, Order issued February 4, 1963, not yet officially reported. Such action certainly eliminates any predictability in Commission rates to be allowed.

Respondent contends that the rate characteristics of a contract should be considered in certificate proceedings; yet the Commission itself in boiler plate language in nearly every certificate issued, states:

> "Further, our action in these proceedings shall not foreclose or prejudice any future proceedings or ob-

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[10] See *H. L. Hunt, et al.,* Commission Opinion No. 369, 28 FPC ....., 46 PUR 3d 62. Dissenting opinion of Commissioner Ross:

> "The specter of triggering is a problem simply because the Commission is unsure as to all the standards which should be applied in 4(e) cases pending the establishment of firm area rates. * * * it would be far better to meet the triggering problem head on by concentrating now on the standards to be employed in 4(e) cases than to put parties to the risk of presenting a *prima facie* case on a subject as unsettled as producer rate increases." (Mimeo. p. 5)

Of the tens of thousands of rate increases filed by producers (other than for tax increases) we have found only *one* in which FPC made the statutory finding of "just and reasonable" or "unjust and unreasonable". *Re Pan American Petroleum Corp.,* 19 FPC 463 (1958). That decision gave no guidance as to the standards which would be used to adjudge economic justification.

jections relating to the operation of any price or related provisions in the gas purchase contract herein involved."

Respondent says that the pricing provisions permitted are reasonably sufficient for the producers' needs in the future (Brief, p. 9 and 14-17). This, of course, is only counsel's opinion, and is belied by the finding of Order No. 232-A that some form of indefinite or flexible pricing is necessary to permit the producer in a long term contract (which the public interest requires) to cope with changing economic conditions. The indefinite provision permitted is of no benefit to producers. First, it can only be employed during a period of five or more years when there is no other provision for price change. This would require the producer to GUESS WHEN the economic conditions during a span of 20 years are to change most, and then eliminate for that 5-year period any other price increase provision. Moreover, the increased price could not be used for price redetermination UNTIL it had been through the "just and reasonable" hearing in the Commission and a probable court review thereof had been completed. The "well nigh interminable delay" in such proceedings would postpone use of such a price so long that any relief gotten would lag behind economic needs for many years and be totally inadequate. Such delay would not be within the Commission's control, for any intervener in a rate increase hearing could seek court review and thus keep "in issue" an increased price approved by the Commission. Furthermore, the "justness and reasonableness" of the higher price would have been determined on the circumstance of one or more *other* producers, which circumstances might be wholly different from those of Petitioner.

Respondent contends that the orders are reasonable in the light of its accumulated experience and mature consid-

eration,[11] however it is to be noted that shortly after it sought to apply Order No. 242 it found that it had not considered at all certain proscribed clauses (Brief, p. 40). In the matter of *The Atlantic Refining Company,* Docket CI63-576 (February 21, 1963), it was there said in granting a rehearing to Atlantic from its prior summary rejection action,

> "As Atlantic recognizes, the so-called 'Memphis type' escalation clause in its contract clearly is prohibited by section 154.93. But we agree that the propriety of such a provision, which is not typically found in contracts between independent producer and pipelines, was not a matter which engaged the Commission's consideration at the time it adopted its present rule. Moreover it is clear that at least some of the objections which we have had with indefinite escalations are not here presented".

How can this Court, or the parties, know how many and what other types of proscribed clauses were proscribed without consideration?

Respondent says Petitioner could have sought waiver of the rules in this instance (Brief, p. 17 and 38). This is a most illusory "right" and would be appropriate only if the validity of the rule itself was conceded. If waiver is to be granted in a changed circumstance, there can never be a change of circumstance between the time the proscribed clause is included in the contract and the time of the initial filing, because this is at most a matter of weeks. If the waiver is not obtained at the time of the initial filing, there

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[11] If "accumulated experience" is to be relied upon as a basis for either rule-making or adjudication, with no opportunity to cross-examine or rebut and without even an opportunity to know the facts on which the conclusion is based, due process of law in proceedings before the FPC will be as dead as the classical Dodo. But such is not the law. *Ohio Bell Telephone Co.* v. *PUC* (1937), 301 U.S. 292, 302, 57 S. Ct. 724; *Republic Aviation Corp.* v. *NLRB* (1945) 324 U.S. 793, 799-800, 65 S. Ct. 982; and *Burlington Truck Lines, Inc.* v. *U.S.* (1962) ..... U.S. ... 83 S. Ct. 239, 244-246.

will never be a clause in the contract upon which the filing for waiver could later be made. The Orders at issue here require that such clauses be deleted before the original filing. Further, unless this Court acts now to invalidate such Orders, the question of waiver will be moot, because the Orders also provide that no pipe line certificate filing may be based on contracts which contain the proscribed provisions. Pipe line buyers cannot agree to such provisions.

Respondent contends that flexible price-changing clauses have induced filing of "floods of" rate increases not predicated on the economic needs of the producer at the time of filing (Brief, p. 13 and 19-20). This assumes that all price increases filed under any flexible pricing provision are *per se* not justifiable. The Commission itself has disproved this. In *Re: Phillips Petroleum Corp.*, Opinion No. 338, 24 FPC 537, the only major producer rate case which has reached a decision on its merits, the Commission found Phillips' jurisdictional costs exceeded its jurisdictional revenues by some nine million dollars during the test year. Many of the changes in rates consolidated in that docket were based on flexible increases.

IV.

Respondent relies for its action on certain non-Natural Gas Act cases for its rule making authority in this instance. As pointed out above, whatever rule making authority Respondent has must derive from the Natural Gas Act and that alone.

The case upon which Respondent seems to place greatest reliance is that of *United States* v. *Storer Broadcasting Co.* (1956), 351 U.S. 192, 76 S. Ct. 763. The *Storer* case arose under the Communications Act (47 U.S.C.A. 301, *et*

seq.). The regulatory scheme of that Act, which permitted the use of public domain for the public benefit by properly qualified applicants, was clearly to prevent a concentration of control of broadcasting facilities. Section 314 (47 U.S.C.A. 314) of that Act expressly forbids ownership or control of stations where the purpose or the effect thereof might be to substantially lessen competition or to restrain commerce. In the light of this, the Commission was clearly authorized to promulgate rules to further the Congressional directive expressed in the Act. Contrarywise, under the Natural Gas Act there is no use of public domain, but property rights of natural gas companies are being subjected to regulation. Under the Communications Act there can be no question of confiscation of private property protected by the Fifth Amendment, whereas under the Natural Gas Act the protection against confiscation is clear.[12] The Communications Act does not regulate rates of licensees. The Natural Gas Act does regulate rates, but contractually established rates are not abrogated by the Act and in fact must be allowed unless *after hearing* they are found unjust and unreasonable. The Acts are wholly different as to the rights and duties of the regulated companies and the Congressional directives to the regulating bodies.

American Trucking Associations, Inc. v. *United States* (1953), 344 U.S. 298, 73 S. Ct. 307, is also relied on by Respondent. This case arose under the Motor Carrier Act, (49 U.S.C.A. 1 *et seq.*) and is wholly inappropriate here. There was an extensive evidentiary hearing — more than 80 witnesses were heard (p. 307). There the *evidence* showed that the Act itself was being abused by the practice which was proscribed (p. 304). Neither of these situations

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[12] *Federal Power Commission* v. *Natural Gas Pipeline Co.* (1942), 315 U.S. 575, 585-6, 72 S. Ct. 736.

are present here. Here no evidentiary hearing was had, and the only real claim of the Commission is that its convenience will be served and its administration of the Act made easier. This is not an abuse of the Act.

The case of *W. J. Dillner Transfer Co.* v. *United States* (W. D. Pa., February 8, 1963), 31 U. S. Law Week 2414, is also relied on. This case is not in point. It held that a rate filing for uncertificated service could be rejected. A hearing had been held. Order 242 would reject both the certificate application and the rate filing, and both of these filings of Petitioner were rejected by the Secretary of the Commission without a hearing.

WHEREFORE, for the above reasons, and those set forth in the initial Brief of Petitioner, Petitioner prays that its relief initially sought be granted.

Respectfully submitted,

.....

MURRAY CHRISTIAN
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Of Counsel:

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April 1, 1963

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

.....

Attorney

In The

United States Court of Appeals

For The Ninth Circuit

No. 18,252

The Superior Oil Company,

Petitioner,

v.

Federal Power Commission,

Respondent.

PETITION FOR REHEARING EN BANC

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SORG PRINTING COMPANY OF TEXAS, HOUSTON, TEXAS

In The

United States Court of Appeals

For The Ninth Circuit

No. 18,252

The Superior Oil Company,

Petitioner,

v.

Federal Power Commission,

Respondent.

PETITION FOR REHEARING EN BANC

To The Honorable United States Court of Appeals For The Ninth Circuit and the Judges Thereof:

Comes now The Superior Oil Company (Superior), Petitioner in the above proceeding, and files this Petition for Rehearing *en banc* of the decision of this Court dated August 26, 1963. Such decision affirmed an order of the Federal Power Commission (Commission) summarily rejecting Superior's filing of an Application for a Certificate of Public Convenience and Necessity under Section 7 of the Natural Gas Act (Act), 15 U.S.C. Sec. 717-717w (717f), and a related Gas Rate Schedule under Section 4, 15 U.S.C. Sec. 717c. For support hereof Superior respectfully shows that this Court erred as to the facts reflected in this record and as to the law applicable to this case and its facts in the following respects:

I.

The Court erred in assuming that the Commission, under its general rule-making power, and without an evidentiary hearing, can do *anything* which it has substantive authority under the Act to do after such a hearing. Admittedly, the

only substantive authority of the Commission stems from Sections 4, 5 or 7 of the Act, each of which requires an evidentiary hearing. Thus the statute itself precludes reliance on its own rule making Section 16, which is limited to "necessary or appropriate" rules to carry out said Sections, and *also precludes* reliance on Section 4 of the Administrative Procedure Act, 5 U.S.C. Sec. 1003, which is applicable only "Except where notice or *hearing* is required by statute, . . .". (emphasis added)

II.

The Court erred in assuming that the substantive and rule-making authority of the Federal Power Commission under the Natural Gas Act relative to the summary rejection of certificate and rate filings is the same as that of the Federal Communications Commission under the Communications Act, 47 U.S.C. 301 et seq., notwithstanding the explicit provision of the later Act (Sec. 313 and 314) prohibiting monopoly and restraints on commerce, which have no counterpart in the Natural Gas Act.

III.

The Court erred in assuming that Superior's right to a hearing prior to the summary rejection of its filings was adequately protected by the waiver provision of the Commission's Regulations, Sec. 1.7(a) and (b), 18 C.F.R. 17(a) and (b), which waiver provision was added to the Commission's Regulations by its Order No. 255 on September 20, 1962 and published 27 F.R. 9499 on September 26, 1962. This waiver provision was *not* a part of the Commission's Regulations at any pertinent date. It was not added until 43 days *after* Superior's Application for Rehearing had been rejected by operation of law on August 8, 1962.

IV.

The Court erred in assuming that the orders here contested (Order No. 242 and the Order of summary rejection) are not "adjudicatory" of any existing right of Superior. The Court ignored the holdings in *United Gas Pipe Line*

Company v. *Mobile Gas Service Corp.* (1956) 350 U.S. 332, 76 S. Ct. 373 (Mobile) and *United Gas Pipe Line Company* v. *Memphis Light, Gas and Water Division* (1958) 358 U.S. 103, 79 S. Ct. 194 (Memphis) and *Willmut Gas & Oil Company* v. *FPC* (D.C. Cir. 1961) 294 F. 2d 245 (Willmut) that a natural gas company has the right to make its own contracts which right has not been abrogated by the Natural Gas Act, and the further right to set its own rates consistent with such contracts, subject only to the authority of the Commission to review such contracts and rates under Section 7 of the Act in the light of public convenience and necessity, as to initial rates, and under Section 4 under the standard of just and reasonable as to changed rates.

V.

The Court erred in extending the holding of the Supreme Court in *Atlantic Refining Company* v. *Public Service Commission* (1959) 360 U.S. 378, 79 S. Ct. 1246 (Cateo) that the Commission must carefully scrutinize and react to the initial prices in a certificate proceeding to include power to remove by condition the provisions of a contract providing possible future price changes, and in failing to recognize that such careful scrutiny and responsible reaction can be given only after the evidentiary hearing required under Section 7 of the Act. The awesome consequence of this error is illustrated by the Commission's opinion issued September 11, 1963, Opinion No. 398-A (Mimeo p. 5), citing this Court's opinion as authority for the Commission's power to prohibit a rate increase above its "existing triggering rate pending conclusion of the area rate proceeding in AR 61-2, *even if such rate were indicated on the basis of individual company cost of service concepts.*" (emphasis added)

VI.

The Court erred in explicitly refusing to follow *Pan American Petroleum Corp.* v. *FPC* (10 Cir., 1963) 317 F. 2d 796 for the reasons stated in that decision.

VII.

The Court erred in holding that the Commission, under the Act, has substantive power to preclude a natural gas company from contracting for future rate changes in the light of *H. L. Hunt* v. *FPC* (5 Cir., 1962), 306 F. 2d 334 (Hunt), holding no such substantive power exists under said Act.

VIII.

The Court erred in assuming that administrative convenience is a sufficient basis to support the order of the Commission, contrary to the holdings in *Mississippi River Fuel Corp.* v. *FPC* (Mississippi) (3 Cir., 1953) 202 F. 2d 899, 902-903; *NLRB* v. *Trancoa Chemical Corp.* (1 Cir., 1962) 303 F. 2d 456, 461; and *La Buy* v. *Howes Leather Co.* (1957) 352 U.S. 249, 259, 77 S. Ct. 309.

IX.

The Court erred in assuming that the Commission's finding that favored nation clauses were contrary to the public interest in *Pure Oil Co.* 25 F.P.C. 383, was affirmed by the Court of Appeals in *Pure Oil Co.* v. *FPC* (7 Cir., 1961) 299 F. 2d 370, when that issue was not before the Court and the Commission was affirmed solely on the basis of its interpretation of the favored nation clause on the record there made. (p. 373).

X.

The Court erred in confusing the contractual authority of a Seller to file for a rate increase with the justness and reasonableness of such filed rate as to which supporting evidence need be offered only in a hearing called *after suspension of such filing.*

XI.

The Court erred in disregarding or misinterpreting the decisions of the Supreme Court and the Courts of Appeals in *Mobile, supra, Memphis, supra, Catco, supra, Mississippi, supra, Hunt, supra,* and *Willmut, supra.*

WHEREFORE, in view of the importance of the issues involved and the explicit and implicit conflicts with other decisions created by the instant holding of this Court, Superior prays that rehearing *en banc* be had and that this Petition be granted and that the above errors be corrected by vacating the Opinion of August 26, 1963 and the Commission's order under review and remanding the matter to the Commission with directions to accept Superior's tendered filings.

Respectfully submitted,

THE SUPERIOR OIL COMPANY

By H. W. Varner

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CERTIFICATE OF COUNSEL

I, H. W. Varner, counsel for The Superior Oil Company, petitioner herein, hereby certify that the foregoing Petition for Rehearing in my judgment is well founded in law and further certify that same is not interposed herein for delay.

Service hereof has been made this day by mailing copies to all opposing counsel as provided in Rule 18 of the Court.

Certified at Houston, Texas this 18 day of September, 1963.

H. W. Varner

H. W. VARNER

No. 18253

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PETER LEROY ORTIZ,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

FRANCIS C. WHELAN,
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THOMAS R. SHERIDAN,
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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Cases

Rules

Statutes

Textbooks

No. 18253

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PETER LEROY ORTIZ,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

I.

JURISDICTIONAL STATEMENT.

On March 28, 1962, the Grand Jury for the Southern District of California returned an Indictment in four counts charging the appellant Peter Leroy Ortiz and his codefendants Thomas Hernandez Gomez and Trinidad Cortez with violations of the narcotics laws of the United States as proscribed in Title 21, United States Code, Section 174. [C. T. 2-5.][1] The appellant and his co-defendants were arraigned in the court of the Honorable William Byrne on April 9, 1962, and all entered pleas of not guilty on April 16, 1962. The case was then transferred to the calendar of the Honorable Thurmond Clarke. [C. T. 6, 7.] On May 25, 1962, the defendants Gomez and Cortez entered pleas of

[1]C. T. refers to Clerk's Transcript of Record.

guilty prior to trial and Peter Leroy Ortiz was tried by the court on that date. The court found the appellant Ortiz not guilty as charged in Count One and guilty as charged in Count Two of the indictment. [C. T. 14.] On June 27, 1962, the court sentenced the appellant Peter Leroy Ortiz to the custody of the Attorney General for a period of five years. [C. T. 18.]

The jurisdiction of the United States District Court is premised on Section 3231 of Title 18, United States Code. The appellant filed a timely notice of appeal on June 27, 1962, pursuant to Rule 39 of the Federal Rules of Criminal Procedure. The jurisdiction of the Court of Appeals to entertain this matter is set forth in Title 28, United States Code, Sections 1291 and 1294.

II.
STATEMENT OF THE FACTS.

In the morning hours of February 28, 1962, Deputy Sheriff Martin Renteria of the Narcotic Detail, Los Angeles Sheriff's Office, accompanied an informant named Felix to the residence of Trinidad Cortez. The deputy was acting in an undercover capacity. Miss Cortez was home and the informant introduced the officer as Carlos. [R. T. 11, 12.][2] In introducing Carlos, Felix described him as the man who was the source of the $80 which Felix had given to Cortez for the purchase of a quarter ounce of heroin. Felix then indicated that, as Cortez well knew, neither Felix nor Carlos had received the narcotics and they were therefore there to obtain satisfaction, either in the form of the heroin ordered or a return of the money. [R. T. 13.] Cortez re-

[2]R. T. refers to Reporter's Transcript of Proceedings.

plied that she was uncertain as to whether she could obtain the money or heroin but if Carlos would return at seven o'clock that evening she would be more definite. [R. T. 15.]

The officer and informant returned to the Cortez residence that evening. [R. T. 15.] Cortez then joined them and they went to a cafe known as Tony Loya's. [R. T. 16.] At the cafe Cortez entered a public telephone booth adjacent to the dance floor; there she placed a telephone call. [R. T. 16.] The officer was unable to ascertain the number dialed but he did overhear Cortez' conversation. She said: "Hello. Is this Leroy? Yes. I have — I can get $75. Do you have anything? O.K. I will call you back tomorrow at one o'clock. Good-bye." [R. T. 16.]

After exiting the booth, Cortez joined the two men and stated that she had spoken with a man named Leroy and that he had said he could obtain a quarter ounce of heroin for Cortez. She stated that she was to call Leroy the next afternoon at one o'clock in order that the specifics of delivery might be arranged. The two men then escorted her back to her home. [R. T. 17.]

At one o'clock the following afternoon, the Deputy Sheriff returned to the Cortez residence. He was unaccompanied. [R. T. 17, 18.] Cortez greeted him with the statement that Leroy had been to her apartment that morning to effect a delivery of the heroin but, finding that she had no money, he had parted with the instruction that she was to call him in the early afternoon. [R. T. 18.] Miss Cortez did not have a phone in her residence, and since it was afternoon, she

and Renteria proceeded to a public phone booth on a street near her home. [R. T. 18, 19.] At this time the deputy saw Cortez dial the number CApitol 1-1212 and heard her state: "Hello. Who is this? Norma — listen; is Leroy there? Where is he? O.K. We will park our car in front of your house. O.K., we are leaving now." [R. T. 20, 21.] The number dialed was that of the defendant Ortiz. [R. T. 71.] The wife of the defendant Ortiz is named Norma. [R. T. 40.]

The two then drove in the deputy's car to 1268 Isabella Street, Los Angeles, California. [R. T. 21, 40.] In the course of their drive Cortez stated to the officer that they were on their way to Peter Leroy's home and Norma had requested her to park down the street from the house. [R. T. 22.] The deputy parked his car as instructed. They were there a short time when they observed the arrival of an automobile. When Cortez noted that one of the two males that left the car was Ortiz, she exited the deputy's vehicle and joined Ortiz, another male identified as Tommy, a female and two small children. The group then entered the building at 1268 Isabella Street. This structure was described at trial as a multiple unit dwelling with two units adjacent to one another on the street level and one unit below these two. The 1268 address is one of the apartments fronting on Isabella Street. [R. T. 40, 41.] Minutes later Cortez left the apartment and returned to Renteria's car. [R. T. 23.] She told the deputy that: "Leroy's got the stuff. He wants the money." Renteria indicated that he was a bit leary of this arrangement and suggested to Cortez that if Leroy was to make the sale, he would first have to produce the narcotics. Cortez

then left the car and re-entered the Ortiz home. After a short time she appeared at the door of the residence and again walked to Renteria's automobile. At that time she approached the driver's side of Renteria's vehicle and handed him the heroin [Ex. 1D] which is the subject of this prosecution, stating: "Well, O.K., here it is. I got it. Give me $75. Count it out." [R. T. 24.] Renteria then gave her the money and she returned to the house. Shortly thereafter, she returned to the deputy's car and they drove away. It was at this time that she stated: "Well, Leroy didn't know . . . Well, he really didn't want to meet you, but maybe the next time; why I'll introduce him to you." [R. T. 25, 26.]

The surveilling officers noted the appellant Peter Leroy Ortiz open the front door to his apartment, walk onto the porch and appear to observe the Renteria vehicle as it pulled away from the curb. [R. T. 42.]

In the conversation as the deputy drove the woman home, Cortez asked for some narcotics for her use. The deputy declined and asked her who gave her the narcotics; to this, she replied: "Leroy did." [R. T. 26, 27.]

On March 12, 1962, the defendant Ortiz was taken into custody by officers of the Federal Bureau of Narcotics and the Los Angeles Sheriff's office. He was escorted to the Hall of Justice Annex in Los Angeles; there he was advised of his right to remain silent and asked whether he desired to make a statement. [R. T. 62, 63.] The defendant Ortiz then voluntarily gave a statement to the officers admitting his complicity in the sale of the heroin on March 1, 1962. [R. T. 64.]

III.

ARGUMENT.

A. The Testimony of Deputy Sheriff Renteria Relative to His Conversations With Co-Defendant Trinidad Cortez on February 28 and March 1, of 1962 Was Not Violative of the Hearsay Rule.

The appellant has expressed a blanket hearsay objection to all conversations between Officer Renteria and Miss Cortez. It is the position of the Government that each of the conversations in question was properly admitted in that the conversations related were either not hearsay or they were hearsay but receivable as an admission against interests. A conversation representative of each ground of admissibility is discussed below.

Deputy Renteria first related a conversation of February 28, 1962, between himself, an informant named Felix and Miss Cortez at the Cortez apartment. He stated that he was introduced by the informant as Carlos, a party who had advanced $80 to the informant so that the informant might purchase narcotics from Cortez. The Deputy stated that he told Cortez that he wanted the narcotics or the return of the money. Cortez then stated that she did not know if she could obtain the narcotics or money; she requested the deputy to return that evening.

Though this conversation took place out of the presence of the appellant Ortiz, it does not constitute hearsay inasmuch as it is not offered for the truth of the matter asserted, namely, that Carlos through the informant had engaged in prior negotiations for the

purchase of narcotics from the defendant Cortez. This conversation was merely introductory and offered to show the context within which the parties were acting. This principle of evidence has recently received expression in this Circuit. In *Busby v. United States* (9th Cir. 1961), 296 F. 2d 328 the Court states at page 332:

> "It is well established that hearsay evidence is that evidence of out of court assertions by third persons which is admitted to prove the truth of the matter asserted. While it is clear that the testimony . . . concerned out of court assertions . . . it is equally clear that his testimony was not admitted to prove the truth of the matter asserted. . . ."

The Court then held that the testimonial evidence in question was admissible.

The next conversation in question, representative of the second ground of admissibility, took place on February 28, 1962. The officer testified that he overheard a telephone conversation which Miss Cortez engaged in at a public telephone booth. The officer then related that during the course of this call the defendant Cortez asked if she was speaking to Leroy and then said that she could obtain $75 and inquired as to whether the party had anything, which in context referred to heroin. She then stated that she would call back the next afternoon.

A relation of this conversation was hearsay but subject to an exception to the rule provided by representative admissions. McCormick (1954), Handbook of the Law of Evidence, Section 244. It is a fundamental

principle of the law of evidence that "when any number of persons associate themselves together in prosecution of a common plan or enterprise, lawful or unlawful, from the very act of associating there arises a kind of partnership, each member being constituted the agent of all, so that the act or declaration of one, in furtherance of the common object, is the act of all, and is admissible as primary and original evidence against them."

> *Hitchman Coal & Coke Co. v. Mitchell* (1917), 245 U. S. 229, 249, 38 S. Ct. 65, 71, 62 L. Ed. 260.

This principle has been recognized by this Court in *Williams v. United States* (9th Cir. 1961), 289 F. 2d 599 and *Fuentes v. United States* (9th Cir. 1960), 283 F. 2d 537.

The appellant questions whether there was enough evidence at this stage of the proceedings to prove the existence of a conspiracy or common scheme and plan. The answer is that there need not be enough evidence at this point. Counsel is not so limited in establishing the existence of a conspiracy or common scheme and plan. The existence of such a concert of action does not often take shape in the form of a single act or statement; rather, many acts and statements normally point to the factual and legal conclusion of the existence of a conspiracy. It is because the proof takes this progression that courts must exercise their discretion to allow the admission of evidence subject to "connecting up", *i.e.,* if the otherwise objectionable testimony does not become admissible by the evidence later adduced as clarification and explanation, the court orders

the original testimony stricken. As stated above, this procedure is within the sound discretion of the trial court and has been approved in this Circuit in the case of *Parente v. United States* (9th Cir. 1957), 249 F. 2d 752, 753. See also *United States v. Sansone* (2d Cir. 1956), 231 F. 2d 887 and *Wigmore on Evidence* (1940), 3d Ed., Sec. 1079(a).

The Government did prove the existence of a conspiracy or common plan to violate the narcotics laws of the United States. The evidence in question therefore was admissible. In determining whether a conspiracy or plan was proven the facts must be viewed in the light most favorable to the Government.

Glasser v. United States (1942), 315 U. S. 60, 62 S. Ct. 457, 86 L. Ed. 680;

Williams v. United States (9th Cir. 1961), 290 F. 2d 451;

Robinson v. United States (9th Cir. 1959), 262 F. 2d 645.

In viewing the facts which were before the trial court it should be kept in mind that the actions of Cortez were apparently uninhibited as she was unaware that Deputy Renteria was a law enforcement officer. Those facts indicative of a criminal conspiracy or plan are: (1) following Renteria's conversation with the defendant Cortez relative to the purchase of narcotics, he overheard a telephone conversation of Cortez in which she asked if she was speaking to Leroy and then asked if the party on the other end of the line had heroin. (2) Defendant Cortez then stated to Renteria that she had conversed with Leroy and would call him again the next afternoon to see

if he had been able to obtain a quarter ounce of heroin. (3) On March 1, 1962, Cortez stated that Leroy called at her apartment in the morning and, upon learning that she did not have the money with her, requested her to call at one o'clock that afternoon regarding the purchase of narcotics. (4) Renteria was present at one o'clock that afternoon when Cortez dialed the number CApitol 1-1212. Renteria overheard Cortez ask for Leroy. He then overheard Cortez tell an individual by the name of Norma that they would park down the street from the house. The phone number at the Ortiz residence was CApitol 1-1212. The wife of the defendant Ortiz is named Norma. (5) The Deputy then drove the defendant Cortez to Peter Leroy Ortiz' home at 1268 Isabella Street. On the way Cortez said that Norma had instructed her to park down the street from the house. (6) Renteria parked his car near the Isabella Street address, and saw Peter Leroy Ortiz arrive in a car. Defendant Cortez then exited Renteria's car, joined appellant Ortiz and entered Ortiz's home with him. (7) Cortez returned minutes later and stated: "Leroy has got the stuff. He wants the money." Renteria then stated that he would not make payment until he had received the narcotics; whereupon Cortez left and returned to Ortiz's home. (8) The defendant Cortez returned to the car with the narcotics and requested payment from Renteria. (9) While driving away from the Ortiz residence Cortez stated "Leroy didn't want to meet you." (10) In response to the deputy's question as to her source, Cortez replied that it was Leroy. (11) The appellant Ortiz confessed the sale of narcotics here in question to Federal Bureau of Narcotics Agent Francis Briggs and other law enforcement officers.

The appellant takes the alternative tack that, if the court accepts the proof of conspiracy, it was in error inasmuch as the Government failed to allege a conspiracy. (Ap. B. pp. 5, 16.)[3] This is not a correct statement of the law. In *Fuentes v. United States, supra,* the Court of Appeals for the Ninth Circuit said at page 539:

> "On this appeal the appellant concedes that the admissions and statements of a co-defendant may be admissible as against the other defendant in the absence of a conspiracy count in the indictment if there is sufficient independent evidence of a concert of action between the defendants to sustain the jury's verdict of guilt. Such is the law. Lutwak v. United States, 344 U. S. 604, 73 S. Ct. 81, 97 L. Ed. 593; United States v. Olweiss, 138 F. 2d 798 at page 800, wherein the court stated:
>
> > 'the notion that the competency of the declarations of a confederate is confined to prosecutions for conspiracy has not the slightest basis; their admission does not depend upon the indictment, but is merely an incidence of the general principle of agency that the acts of any agent, within the scope of his authority, are competent against the principal.' "

With the above in mind it is apparent that the second conversation is admissible against Ortiz as an admission, a recognized exception to the hearsay rule.

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[3]Ap. B. refers to the Appellant's Brief.

See Wigmore on Evidence (1940), 3d Ed., Secs. 1078, 1079. The Government bases the admission of all subsequent conversations upon the rationale above cited in support of the second conversation.

B. The Court Did Not Err in Admitting the Confession of the Appellant.

The evidence revealed that when Mr. Ortiz was taken into custody he was apprized of the fact that the officers possessed a warrant for his arrest and that he was charged with violating the Federal Narcotic Laws. He was then informed that the law did not require him to make any statement to the officers and that if he chose to do so, the statements could be used against him in a court of law. [R. T. 58.]

Subsequently appellant was taken to the Hall of Justice Annex and there the officers explained the charges pending against him and the penalty provision provided by the statute violated. In the course of conversation, the record does not indicate with exactitude the sequence, the appellant gave the officers a full confession. [R. T. 64.] Mr. Ortiz was then asked whether he was interested in cooperating with the Government by acting in the capacity of an informant. He indicated a willingness to act in this capacity and he was therefore released on a bail of $1,000 in order that he might perform this governmental service.

When brought to trial the appellant did not repudiate the making of the statement; rather, he stated that it was not the truth as it was involuntarily given. Over objection the court held the confession to be voluntary. The question now arises as to whether the admission of this confession was error. Judge Learned

Hand stated in the case of *United States v. Gottfried* (2d Cir. 1948), 165 F. 2d 360, 367:

> ". . . Whether a confession is voluntary depends upon the facts that surround it, and the judge's decision is final as to its competence except in those cases . . . in which his finding of fact is plainly untenable."

In discussing this situation in the Ninth Circuit, this Court has stated in *La Moore v. United States* (9th Cir. 1950), 180 F. 2d 49 at 54:

> "In determining whether a confession . . . is voluntary or involuntary, the trial court 'is necessarily vested with a very large discretion, which will not be disturbed on appeal, unless a clear abuse thereof is shown.' Mangum v. United States (9th Cir.), 289 Fed. 213."

In light of the facts adduced at trial, the authority cited above and *Glasser v. United States, supra,* wherein it was stated that upon appeal the evidence must be viewed in light most favorable to the Government, it is the contention of the United States that the court did not abuse its authority in accepting the confession in question.

Alternatively, the appellant contends that his confession was invalidated in that he was experiencing withdrawal symptoms at the time of his questioning and that this was evidenced by a bloody nose, cramps and his sinking to his knees on the floor during the interrogation. [R. T. 68, 73.] Such assertions were categorically denied by the officers who were present. [R. T. 77, 98.] This matter is disposed of under the authority of the *Glasser* case, *supra.*

As an adjunct of the preceding argument, Ortiz states that his confession is vitiated by the fact that he was under the influence of narcotics at the time he made the statement. This question has received treatment in Wigmore on Evidence (1940), 3d Ed. Sec. 841(2) as supplemented in 1962. He states:

> "A confession made while . . . under the influence of narcotics is governed by the general principle of testimonial capacity, and is therefore usually held admissible . . ."

In discussing testimonial capacity, Wigmore, *supra,* Sec. 499, states:

> "[T]he question is, . . . whether the witness was so bereft of his power of observation, recollection, or narration, that he is thoroughly untrustworthy as a witness on the subject at hand."

It is true that Government's witness, Officer Velasquez, indicated that the subject evidenced some symptoms of being under the influence of a narcotic drug. [R. T. 80.] However, there is no categorical statement that he was under the influence and the matter is a question for the judge as the trier of fact. But assuming, *arguendo,* that the appellant was under the influence of a narcotic drug, the question then becomes whether his ability to comprehend questions asked of him was impaired and whether he was coherent. The uncontradicted testimony of the expert was that the defendant appeared coherent in that he followed the questions asked of him and answered in an intelligible manner. [R. T. 82.]

IV.
CONCLUSION.

On the facts in this record and the law applicable thereto, and for the reasons stated herein, the judgment entered against appellant Peter Leroy Ortiz is free from error and should be affirmed.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WILLIAM D. KELLER

No. 18255

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE ANTHONY ROSSETTI,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

No. 18255

IN THE

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FOR THE NINTH CIRCUIT

GEORGE ANTHONY ROSSETTI,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

I.

STATEMENT OF JURISDICTION.

This is an appeal from the judgment of the United States District Court for the Southern District of California adjudging appellant to be guilty as charged in Count One of a two-count Indictment following a jury trial.

The offense occurred in the Southern District of California. The District Court had jurisdiction by virtue of Title 18, United States Code, Section 3231. This Court has jurisdiction to entertain this appeal from the judgment under Sections 1291 and 1294 of Title 28, United States Code.

II.
STATEMENT OF THE CASE.

Count One of the Indictment, which is set forth as Appendix A, charges appellant together with co-defendant Pasquale Frank Crea with aiding and abetting the commission of the offense by co-defendant Joseph Patrick Kasamis of illegally importing approximately thirty-five pounds of marihuana into the United States from Mexico, in violation of United States Code, Title 21, Section 176(a) and Title 18, Section 2. The Indictment was returned March 14, 1962. [C. T. 2.]*

Co-defendant Joseph Patrick Kasamis was separately tried before a jury on April 10, 11 and 12, 1962, and was convicted by the jury on both counts of the Indictment on April 12, 1962. [C. T. 10-12.]

Appellant plead not guilty on May 29, 1962, to both counts of the Indictment and a jury trial was commenced before United States District Judge Fred Kunzel as to both appellant and co-defendant Pasquale Frank Crea on said date. Appellant's motion to strike the testimony of co-defendant Joseph Patrick Kasamis, or to grant a mistrial was presented and denied on May 29, 1962. [C. T. 49, R. T. 85-88.] Appellee rested its case on May 31 and a motion for acquittal was granted on both counts as to Crea and on Count Two as to Rossetti. [C. T. 51, R. T. 227-233.] Appellant rested, no further evidence being introduced, and renewed his motion for judgment of acquittal as to Count One. [R. T. 233, 242.] The jury returned a verdict of

*C. T. will refer to Clerk's Transcript of Record and R. T. will refer to Reporter's Transcript of Proceedings.

guilty as to appellant on Count One. [C. T. 52.] Appellant renewed his motion for judgment of acquittal which was denied. [R. T. 299-301.] Appellant filed a motion for judgment of acquittal or new trial. [C. T. 38, 40, 53.] Appellee filed its opposition [C. T. 56] and supplemental opposition. [C. T. 64.] The motion was denied on July 20, 1962. [R. T. 307-312; 315-329; 332-348.]

The Court sentenced appellant to seven years imprisonment on Count One of the Indictment. [C. T. 76, R. T. 350.] Appellant filed a timely notice of appeal. [C. T. 78.]

III.

ERROR SPECIFIED.

Appellant has specified the following points on appeal:

1. The trial court erred in admitting evidence of flight, in its instructions thereon and in not granting new trial to "rebut the inference of flight."

2. The trial court erred in allowing the testimony of co-defendant Kasamis and in its instructions upon said testimony.

3. The evidence is insufficient to support a conviction.

4. The statute under which appellant was charged "is and was unconstitutional."

IV.

STATEMENT OF THE FACTS.

At approximately 10:10 a.m. in the morning of February 22, 1962, co-defendant Joseph Patrick Kasamis, the sole occupant of a 1952 Oldsmobile, license ATW-911, drove said automobile into the United States from Mexico at San Ysidro, California. [R. T. 50-52.] Customs Inspector Thomas Welch asked Kasamis what he was bringing into the United States and Kasamis declared only a child's leather purse laying in the back seat of the car. [R. T. 52.] The inspector had no information on the car but observed that Kasamis appeared very nervous and asked him to open the trunk of the automobile which Kasamis did with the key thereto after turning the ignition off, taking the keys therefrom, and walking to the trunk of the vehicle. [R. T. 52.] The inspector did not observe anything hidden in the trunk at that time and with the ignition key furnished him by Kasamis drove the car to a secondary area where he searched the car. [R. T. 52, 53.] Marihuana seeds were observed on the floor mat in the back seat area of the car. Thereafter a burlap sack of marihuana was found in the trunk, behind a piece of cardboard behind the spare tire. Following that there were found concealed six kilo brick packages in a compartment under the hood back of the right fender and eight kilo packages in a similar compartment on the left side, totaling about thirty-five pounds of marihuana. [R. T. 55-56.] It was necessary to remove plates from the bottom of the automobile before the marihuana in the two compartments could be removed.

Agent Gates testified that marihuana was valued on the illicit market at that time in Tijuana at between $20.00 to $45.00 a kilo. [R. T. 196-198.]

Kasamis testified that he drove aforesaid Oldsmobile from Mexico into the United States; and that he had received the keys to said automobile earlier that same morning, February 22, 1962. [R. T. 79, 82-84.] Gates searched Kasamis later that morning at about 11:45 a.m. and found less than a dollar in change on his person. [R. T. 121.]

Prior to the date Kasamis drove said 1952 Oldsmobile into the United States from Tijuana, appellant had placed it on a lot for sale in Kasamis' home community. Homer Bodum, an owner of the Jet Center Motors in Lancaster, California, testified that on December 31, 1961, appellant alone brought said Oldsmobile on to his lot there where Rossetti signed a consignment for sale of same for $150.00 net to Rossetti. [R. T. 89-92.] The consignment signed "George Rossetti" read in pertinent part as follows: "I, the undersigned, hereby consign my Oldsmobile '52, License No. ATW-911 to Jet Motors." [Ex. 3.] The vehicle remained on Bodum's lot for about thirty days thereafter during which period appellant appeared on the lot two or three times [R. T. 92, 93] accompanied at least once by co-defendant Crea. The condition of the car was discussed with Rossetti who said he would fix a main bearing, but the automobile was removed from the lot without being sold to anyone else by Bodum. [R. T. 93-95.]

Marion Dickey, Deputy Sheriff, Kern County, California, was stationed in Rosamond in that county in

January and February of 1962, and had known Kasamis for some time in that area, as well as having seen him together with appellant and Crea in the latter part of January or early February at the Wayside Cafe in Rosamond and also in front of the cafe. [R. T. 218, 219].

Ethel Kasamis, testified that her son, Joseph Patrick Kasamis, was living with her at their home in Lancaster on February 20, 1962, and was working on "the car with his dad", when appellant pulled up about 11:30 a.m. that morning in a red and white car and talked with her son at the latter car for about five or six minutes. [R. T. 111, 113, 119.] Shortly after that her son entered the house, stayed about a minute, put on a jacket, returned to where appellant was waiting at the side of the red and white car, and left with him in said vehicle. [R. T. 113-114.]

Kasamis was next observed at 1:10 p.m. that same afternoon in the 1952 Oldsmobile, License ATW 911, by Los Angeles County Deputy Sheriff Girard Kipp, proceeding south on Highway 6 from the Kern-Los Angeles County line to Lancaster, in Los Angeles County, California. [R. T. 97, 98.] Kipp observed two persons in the car, recognized the driver as being Kasamis and followed the automobile for about twelve miles, stopping the car at about 1:37 p.m. that afternoon, when he recognized the passenger as co-defendant Crea, a person he had seen before. [R. T. 98, 102, 107.] Kipp examined the registration certificate of said vehicle which Crea produced from his wallet on which the name of Pasquale Crea appeared as the registered owner. [R. T. 103, 104, 108.] The registration certificate was returned to Crea, and Kasamis and Crea continued driving south in the vehicle. [R. T. 105, 108.]

Following this, on the night of February 21, appellant driving his 1954 Oldsmobile, license GFU-128, registered into the Holiday Inn Motel, San Ysidro, California, about two blocks from the Port of Entry into Mexico, with two other persons, as shown by the registration form signed by appellant on which he stated the number of persons registering as three and the license of his car GFU-128. [R. T. 147-150; 216, 217; Ex. 8.]

Following the discovery of the marihuana in the 1952 Oldsmobile, Customs Agent Gates went to the Lancaster, California area, where he later saw Mrs. Mowry, the manager of a motel or group of cabins known as Actis Gardens. Mrs. Mowry took Gates to the cabin of Rossetti on the afternoon of February 23, which was vacant of people but which was not clean and in which there were several old items of clothing as well as several items of food in the refrigerator. [R. T. 124-127.]

Mrs. Nita Mowry, the manager of Actis Gardens which constituted a group of small cabins located about six miles south of Mojave, California, testified that appellant and co-defendant Crea and their families moved into Cabin 16 and Cabin P respectively of said court at the same time and lived there continuously for about a year prior to February 22, 1962. Rossetti and his wife had a daughter Deborah, also known as Debbie, while Crea and his wife had no children. Both Rossetti and Crea operated vehicles including a red one by appellant, and both families and their vehicles were gone on February 23 when the manager went to appellant's cabin (Cabin P), which was unlocked and the personal things of the Rossetti family were gone. She locked up Cabin P with her master key, following which she

cleaned up the cabin and rented it to another person; and appellant never returned. [R. T. 162-167.] Arrangements at first were made to have the rent of appellant and Crea taken care of with one of the co-owners, Tony Actis, but "later on they were supposed to pay rent, but they didn't." [R. T. 168.] Mrs. Mowry never collected any rent at all at any time from appellant. [R. T. 168.]

Beatrice Keyes testified that on February 22, 1962, she resided in Cabin O, Actis Gardens, six miles from Mojave, California, which was next to the Cabin P in which appellant, his wife and daughter Debbie lived prior to that time. Co-defendant Crea and his wife who did not have children lived in Cabin 16. Mrs. Keyes was home on the afternoon of February 22 and right after the school bus arrived about 4:00 p.m., observed activity in the vicinity of Cabin 16 where Crea and his wife loaded their car and moved from that cabin. She continued to live in Actis Gardens but thereafter she did not see either one of the Rossetti or Crea families at the cabins heretofore occupied by them. [R. T. 156-160.] Other than having previously heard from appellant's daughter something to the effect that the Rossettis were going to move in July, she had not heard of any move other than that same afternoon, February 22 when Rossetti's daughter came in to say goodbye. [R. T. 161.]

Garlan Frix, the principal of Mojave Elementary School located in Mojave, California, testified that that school was in session on February 22 and that Deborah Rossetti whose address was Actis Gardens had been in attendance there from February 6, 1961, until February 22, 1962, which was the last day she attended, although

she was carried on the rolls of the school until March 6, 1962. Frix received no notification for the withdrawal of appellant's child from school. [R. T. 152-154.]

Frank A. Kern, Deputy Sheriff for the County of Kern, testified that his daughter, Kelly Lee Kern, attended school at the Mojave Elementary school about one block from his home in Mojave, California, on February 22, 1962, and that he saw his daughter and Deborah Rossetti at his home after school on that date. The two girls had previously played together frequently. The two girls left his house between 4:00 and 4:30 p.m. that date and about ten minutes later Deborah Rossetti's mother came by the house and he later saw his daughter about 4:45 or 5:00 p.m. but appellant's daughter was no longer with his daughter. [R. T. 221-224.]

Mario Cozzi, a Customs Agent stationed in New York City on March 13, 1962, saw a 1954 Oldsmobile, two-door hardtop, California license GFU 128 in that city, in front of a residence at 1460 85th Street, Brooklyn, New York. [R. T. 178.] Cozzi arrested appellant in said residence and appellant was asked by Agent Cozzi why he left California in a hurry and appellant stated that he didn't leave in a hurry; whereupon the agent asked when he had left and appellant "figured out the date, and he figured it was about February 19th." [R. T. 179.] Appellant admitted to Agent Cozzi that he and Crea had received $500.00 before he left California. [R. T. 179-180.] Appellant also admitted that the 1954 Oldsmobile observed in front of his New York residence, was his vehicle. Said vehicle was registered to appellant. [Ex. 12; R. T. 190.]

V.

ARGUMENT.

A. The Trial Court Did Not Err in Admitting Evidence of Flight and in Its Instructions Thereon.

At the outset it should be noted that the court instructed that evidence of flight of a defendant "is not sufficient in itself to establish his guilt, but is a fact which, if proved, may be considered by the jury in the light of all other proved facts in deciding the question of his guilt or innocence." The court then went on to instruct further "whether or not evidence of flight shows a consciousness of guilt, and the significance, if any, to be attached to such a circumstance, are matters for determination by you, the jury."

The government submits that the facts fully warranted the giving of such an instruction especially in the manner in which it was worded. Rossetti had been identified by witness Bodum as consigning his 1952 Oldsmobile, license ATW 911, for sale on December 31, 1961, which automobile was thereafter about 30 days later taken off the lot without having been sold. Rossetti was then identified by Mrs. Kasamis as picking up her son, co-defendant Kasamis, in a red and white automobile about 11:30 a.m. on February 20, 1962, at her home in Lancaster, California. In the early morning hours of February 22, 1962, Rossetti was in a motel at San Ysidro, California, a couple of blocks from the San Diego Port of Entry with two other persons it may reasonably be inferred were Kasamis and Crea, in his 1954 Oldsmobile, license GFU 128, on which registration the night of February 21, he gave an address in Lancaster which was not his correct

address. Kasamis, from Lancaster, was shortly thereafter apprehended at the port of entry in Rossetti's 1952 Oldsmobile at about 10:10 a.m. on February 22, with approximately 35 pounds of marihuana packed in said automobile to which he had received the keys earlier that morning. Part of the marihuana was in a gunny sack in the trunk of the said automobile which Kasamis opened with a key to said trunk.

The government's evidence further showed that both Rossetti and his friend, co-defendant Crea, lived at the Actis Gardens in Mojave with their families until February 22, the day of Kasamis' apprehension when both families suddenly moved. The daughter of defendant Rossetti, Deborah Rossetti, had commenced school on February 6, 1961, attending the Mojave Elementary School, to and including February 22, 1962, after which she was absent although carried on the rolls until March 6, 1962, there having been no notification received by the principal as to her withdrawal. Mrs. Beatrice Keyes, the next door neighbor of the Rossettis, and Nita Mowry, manager of the Actis Gardens, testified that defendant Rossetti and his family lived at Actis Courts until February 22. Their testimony, taken as a whole, reflects that both of the entire families left the area between 4 and 5:00 p.m. on February 22. Previously Mrs. Keyes had understood that the Rossettis were going to move in July but on the night of that afternoon, February 22, for the first time Deborah Rossetti advised that they were then moving. Prior to the time Deborah Rossetti told the Keyes that they were leaving, she had not come home from school but instead had stayed with the daughter of Mr. Kern about a block from the Mojave Elementary School where his

daughter and Deborah attended school. The two young girls left Mr. Kern's house about 4 to 4:30 p.m. and thereafter ten or twenty minutes later Deborah's mother, defendant's wife, came looking for her daughter and obviously located her shortly thereafter.

On March 13, 1962, Customs Agent Cozzi observed Rossetti's Oldsmobile, California license GFU 128, in front of a residence in New York where he later talked to Rossetti. Significantly, at that time Rossetti, in stating that he didn't leave California in a hurry, placed the time of his departure from California at about February 19, or three days earlier than the date when he was in fact in California. The government contends the appellant thus deliberately placed himself in Arizona at the home of Pat Crea's brother or cousin at least two days before a time when he knew that he had been in a motel in San Ysidro. The actions surrounding the hurried moving of himself and his family from Actis Gardens in Mojave to New York were certainly evidence of his flight which could be considered in the light of all the circumstances. The jury had a right to determine the significance, if any, of these actions, occurring as they did in Mojave, and later in New York, particularly with relation to the apprehension of Kasamis in appellant's vehicle, and the location of appellant in the same vicinity as Kasamis earlier the same day.

Appellant has produced a letter from the school teacher presumably as evidence that here was at most a mere coincidental departure by the defendant. [C. T. 53.] However, the point which the government would make is that the circumstances here show a hurried departure of the nature which constituted flight, irregard-

less of the fact the Rossettis might have been planning to leave the Mojave area at some future time. Even considering this letter at its face value, the facts still show that the departure was obviously unplanned on the date it took place, for a person who has been two-hundred miles away from home a short time before doesn't move or cause his family to be moved in the manner in which it was moved here unless it was more than a mere departure. Also see letter dated 7-16-62 of Miss Blakey, Exhibit II [C. T. 64], in which the teacher of Deborah was not advised either by appellant's daughter or her parents that Deborah Rossetti would not return to school on February 23, 1962. Therefore, the suggestion of appellant that Rossettis had advised others of a contemplated future move does not of itself preclude the jury from determining what, if any, significance was to be attached to the circumstances of the move which was in fact made.

The fact that there was not evidence of later concealment of the nature of denial of identity or change of identity many miles across the country from Mojave in New York City on March 13 when interviewed by a Customs Agent there does not render the other evidence inadmissible. For as stated in *Gicinto v. United States,* 212 F. 2d 8, 11, cert. denied 348 U. S. 884 (1954), evidence of flight is always admissible, especially when the conduct of the defendant is apparently inconsistent with innocence. In the *Gicinto* case, *supra,* there does not appear to be any evidence of subsequent concealment. In fact the only evidence of flight, gleaned from a reading of the Circuit Court opinion, which was produced in that case was the obtaining of a passport by defendant immediately preceding the commission of

the crimes alleged. Trial counsel in the case below, *United States v. Gicinto,* 114 F. Supp. 204 (W. D. Missouri, 1953), had previously moved for a judgment of acquittal or in the alternative for a new trial including a ground directed to this same point. However, the trial court pointed out that the passport was offered as evidence of flight and added at page 205 that such evidence was competent in the light of all the circumstances.

As to the contention that appellant could not have anticipated that the government would have offered evidence of the moving of his family to New York, the record on this phase shows an awareness of the situation now sought to be broached in greater detail. On cross-examination of the school principal, Mr. Frix, and of the neighbor, Mrs. Keyes, inquiry was made as to whether the Rossetti family contemplated moving by contacts by Mrs. Rossetti or Deborah with Deborah's teacher or neighbors. Furthermore, counsel for Rossetti had available before the trial of Rossetti, which commenced May 29, 1962, the transcript of the trial of Kasamis [see R. T. 46, 47] which started April 10, 1962, after the arrest of Rossetti on March 13, 1962. It certainly could have been anticipated from the knowledge which counsel for appellant then had both from the record of that case and his clients Rossetti and Crea that their move from Actis Gardens on the same date as Kasamis' apprehension would be a factor in their case.

Because of the failure of appellant to offer any evidence in rebuttal, on flight, to ask for time within which to offer such evidence, and to show any real basis for that failure, there is lacking the convincing

showing of exceptional circumstances essential to the exercise of the trial court's discretion in granting a new trial.

As stated in *United States v. Soblen,* 203 F. Supp. 542 (1961) at page 564 (affirmed 301 F. 2d 236), "A motion for new trial in a criminal case will be granted with caution and only in exceptional circumstances." The trial court goes on there to point out the wide discretion which the court has in determining a motion for new trial and the fact that the burden of proving grounds to support the motion for new trial rests upon the defendant. (p. 564.)

Finally, in passing on a motion in the *Soblen* case for a new trial upon allegedly newly discovered evidence, the trial court stated as follows: (pp. 564, 565.)

> "A motion for a new trial will be denied where the defense fails to prove its due diligence to secure, before or during the trial, the allegedly newly discovered evidence.
>
> "Where the allegedly newly discovered evidence was known to the defense or readily obtainable by it before or during the trial and the defense trial strategy was not to utilize such known or obtainable evidence during the trial, the decision by the defense to change its strategy after an unfavorable verdict does not render the evidence 'newly discovered.' "

It is submitted that the trial court properly received and instructed the jury on the evidence of flight in this case; and properly denied the motion for new trial.

B. The Trial Court Did Not Err in Allowing the Testimony of Co-Defendant Kasamis and in Its Instructions Thereon.

Co-defendant Kasamis was called as a witness by the government and testified as set forth in Appendix B that he had entered the United States in a 1952 Oldsmobile, green and black, on Thursday morning, February 22, 1962; that he opened the trunk of that vehicle for a Customs official at that point; and that he had received the keys to that automobile that same morning. [R. T. 79, 82-84.] Kasamis had taken the stand and testified similarly on these points in his own behalf at an earlier trial. No questions on any other points [R. T. 80-82] were asked by counsel for the government.

The witness claimed that the answers to the questions would incriminate him under the Fifth Amendment, but answered the questions after being directed to answer the first question. The defense objected to the government calling this witness because defense counsel advised the prosecution that he, defense counsel, had been advised by said witness that said witness would claim a privilege against self-incrimination. [R. T. 48.] The prosecutor advised the court that the government felt it had the right to call the witness as to certain limited matters which the witness had stated both in an original statement to customs agents and at his trial. [R. T. 48.]

The claim that the answers to the three questions which co-defendant was called upon to answer would tend to incriminate him of a possible conspiracy or marihuana tax violation in addition to his conviction on the

charge of illegally importing and concealing marihuana in violation of Section 276(a) seems untenable in view of the prohibitions against subsequent criminal prosecutions under the double jeopardy clause of the Constitution. See, *Sealfon v. United States,* 332 U. S. 575; also *United States v. Sabella,* 272 F. 2d 206, 211 (2nd Cir. 1959.)

In any event, the privilege could only be claimed by Kasamis and he waived it by voluntarily testifying at the first trial. It is pointed out in *Rogers v. United States,* 179 F. 2d 559, that when the constitutional right of a witness not to incriminate himself by his own testimony comes into conflict with the right of the Government to adduce the testimony of every citizen in criminal prosecutions, the court must give both principles a reasonable construction, so as to preserve them both to a reasonable extent. *Burr v. United States,* 25 Fed. Cas. 38. The Supreme Court in affirming the foregoing Tenth Circuit case of *Rogers v. United States, supra,* noted that the privilege is purely a personal one for the benefit of the witness and that it may be waived. If waived, the Supreme Court states, and a witness has voluntarily answered as to materially criminating facts, he cannot invoke the privilege to avoid disclosure of the details. This reasoning applies, *a fortiori,* when the questions asked pertain to facts to which a witness already testified at an earlier date, and answers beyond his previous testimony were not asked for by the prosecution. This court in *Hashagen v. United States,* 283 F. 2d 345, at page 354 (1960), held that a witness could not refuse to answer a question calling for an answer seeking to elicit the same fact which her

prior testimony had revealed. It was therefore proper here to elicit the same facts which Kasamis' prior testimony had revealed.

The cases cited by appellant pertain to those instances in which the witness refused or was not required to testify and are not appropriate, for in this case the witness did testify. Therefore, no error and certainly no plain error was committed in not instructing the jury in a manner similar to those cases as is belatedly urged by counsel. See Rules 30 and 52, Federal Rules of Criminal Procedure. This case is readily distinguished from the case of *United States v. Hiss,* 185 F. 2d 822 (2nd Cir. 1950), where the witness Rosen was called over objection of defendant by the government, knowing that he would refuse to answer some of the questions. The witness there did claim the privilege against self incrimination and refuse to answer certain questions. Notwithstanding, the court, noting the view of Professor Wigmore that the privilege was but an option to refuse to answer and not a prohibition of inquiry, affirmed. Here it cannot be said that prosecution had knowledge of an impending refusal of the nature of that in the *Hiss* case, particularly in view of the invalidity of the instant claim and the answers ultimately given.

The advice of the defense to the prosecution that the witness would take the Fifth Amendment when called was without substance and furthermore was immaterial. As in the case of *United States v. Romero,* 249 F. 2d 371 (2nd Cir. 1957), Kasamis was in the position of any witness subject to court process and he could have been compelled to testify for either side. As here, the

witness in the *Romero* case, Ottomano, had previously been convicted for his part in the same transaction concerning which he was called to testify as to a party thereto. The Supreme Court in *Reina v. United States*, 364 U. S. 507, at 513 cites the *Romero* case, *supra,* for the proposition that "the ordinary rule is that once a person is convicted of a crime, he no longer has the privilege against self-incrimination as he can no longer be incriminated by his testimony about said crime." See also *United States v. Cioffi* (2nd Cir. 1957), 242 F. 2d 473. In the case of *United States v. Gernie* (2nd Cir. 1957), 252 F. 2d 664, Cert. Den. 78 S. Ct. 1006, it was urged that it was error for the government to call a witness in view of his refusal to testify regarding the source of heroin of which he had admitted possession. The court held that the government had a right to bring forward such witnesses as may have had knowledge bearing on the case, and under such circumstances it made no difference whether the government had reason to believe that the witness would refuse to testify. In this case the witness, Kasamis, by way of contrast to the witness in the *Gernie* case who refused to testify, did finally testify.

In conclusion, the claimed Fifth Amendment privilege of Kasamis had been waived by his previous voluntary testimony, was not well taken, and in any event the government had a right to call him.

C. The Evidence Amply Supports the Jury's Verdict of Guilty.

A conviction should be sustained on appeal if there is substantial evidence, taking the view most favorable to the government to support it. In considering the facts the reviewing court must grant every reasonable intendment in favor of appellee.

United States v. Glasser, 315 U. S. 60, 80 (1942);

Arena v. United States, 226 F. 2d 227, 229 (9th Cir. 1956), Cert. Den. 350 U. S. 954 (1956);

Bolen v. United States, 303 F. 2d 870, 874 (9th Cir. 1962).

A brief review of the evidence demonstrates that appellant procured Kasamis as a "mule" in a scheme to smuggle marihuana into the United States and aided and abetted that smuggling in a vehicle in which appellant had an interest and in which was carefully concealed 35 pounds of marihuana. The amount of the contraband was so substantial that it had to be packed in three locations in said vehicle, including the trunk, to which Kasamis had the keys furnished to him just prior to entry that morning. That the contraband was effectively concealed is unquestioned because it was not found until examination at the secondary inspection at the San Ysidro Port of Entry. A Federal crime of smuggling has been made out.

There is substantial evidence that appellant procured Kasamis to go to Tijuana for the purpose of smuggling marihuana and aided and abetted him in the commission of the offense.

First, consider what it required for Kasamis to succeed in bringing this amount of marihuana into the United States. He had to be able to get to Tijuana, to have the money to purchase the marihuana, and most important to have an automobile to drive it across the international boundary into the United States. Kasamis had none of these means at his home in Lancaster at about noon on February 20. On the other hand appellant had money as well as an automobile. In less than two days from that time when appellant came to Kasamis' house and got him, Kasamis was in appellant's vehicle with marihuana worth $350.00 to $500.00 at San Ysidro 200 miles from his home with less than $1.00 in his pocket.

At the time Rossetti picked up Kasamis the latter was in Lancaster, California, without any money working with his father at home. After a short argument appellant persuaded Kasamis to come with him. That it was to be a trip in the 1952 Oldsmobile is shown by the fact that after talking with appellant, Kasamis came in to his house, got his jacket, and thereafter within an hour and a half was driving that car south with Crea as his passenger. Appellant had exercised ownership rights to that automobile prior to the time Kasamis entered the United States with it on February 22. The evidence has shown that there was no interest adverse to appellant in said vehicle from December 31, 1961 to the time Kasamis entered the United States with it. Appellant's continuing interest in the vehicle is corroborated by Kasamis' presence, as well as that of Rossetti's close friend Crea, therein shortly after Kasamis was picked up by appellant. Crea's production

from his pocket of the car registration in his name is also consistent with appellant's continuing interest and consent for Kasamis' use, in view of the prior association of these three persons together and the joint interest shown by Rossetti and Crea in its sale before the car was withdrawn from the lot. The interest of Rossetti and his dominion and control over this vehicle has been shown to be greater than that of appellant in the vehicle in which heroin was brought into the United States in case No. 17,966, *O'Neal v. United States,* affirmed by this court November 21, 1962.

Appellant also proceeded south in his 1954 Oldsmobile, license GFU-128, after picking up Kasamis, for Rossetti registered in a motel two blocks north of the port of entry from Tijuana with two other persons the night of February 21. It is reasonable to infer from the evidence that Rossetti picked up Kasamis in Lancaster, took him to the 1952 Oldsmobile, in which Kasamis and Crea proceeded to the same motel into which they were registered by Rossetti. Why else would appellant be that far from his home in that motel, close to where his car was found, except for the purpose of shepherding said car through the port of entry with its extremely valuable cargo?

Shortly after this of course Kasamis was caught in this same 1952 Oldsmobile, with thirty-five pounds of marihuana therein, including a substantial amount in the trunk, having keys to the ignition and the trunk. to which he had come into possession that same morning prior to 10:00 a.m.

In addition to the foregoing circumstances, consider also appellant's actions following the apprehension of

Kasamis. Rossetti left the vicinity two blocks from the Port of Entry where Kasamis was stopped and after a period of time which it would take to drive from San Ysidro to his home at Actis Gardens, great activity occurred there. After the school bus arrived at Actis Gardens and Deborah had not returned home, Rossetti's wife picked up her daughter from a point a considerable distance away where she was playing normally with a school friend. Rossetti's family and the Crea family which lived adjacent and had come to Actis Gardens at the same time about a year ago, both moved at about 5:00 p.m. on February 22. No notice was given by the Rossetti family to the daughter's school of a move to occur at this time, and no arrangements were made with the landlady then in charge of their rent. The first that an adjacent neighbor learned of a contemplated move on that particular date was just before the family left when the daughter came in to say good-bye. Rossetti had been living with his family until February 22 and the jury could reasonably infer from all the circumstances that he left San Ysidro when his car failed to come through the Port, hurried home gathered the family belongings together and left with his family in great haste. Why else would appellant leave in such a manner except for the fact that his attempt to shepherd his car with marihuana through the Port of Entry had failed?

As previously stated, the evidence must be viewed in the light most favorable to the Government, including the reasonable inferences to be drawn therefrom.

Bolen v. United States, supra.

All personal belongings of the Rossetti family were gone on February 23 the next day; Rossetti did not thereafter return to his home and was located across the country in New York City on March 13, 1962. The conduct of appellant in his flight from California without making any plans for taking his child out of school; without taking care of his rent or otherwise notifying the manager of the court; abandoning his vehicle which Kasamis was driving; and in making a deliberately false statement to Agent Cozzi that he had left the area on a date about three days earlier than February 22 all showed a consciousness of guilt of the offense charged.

Taking all the circumstances into consideration it must be concluded that a reasonable minded trier of fact could find beyond a reasonable doubt that appellant knowingly aided and abetted Kasamis in bringing in the marihuana.

D. The Statute (21 U. S. C. 176(a)) Is Constitutional.

Appellant, convicted of aiding and abetting co-defendant Kasamis in the commission of the offense of illegal importation of marihuana in violation of Section 176(a) of Title 21, United States Code, apparently contends this statute is unconstitutional in that compliance with the customs laws calling for invoicing, inspection, entry, and/or declaration of any marihuana to be imported into the United States require admission of possession of marihuana and thus incriminate him of a violation of a separate and distinct federal offense, namely, Section 4744 of Title 26, United States Code.

Appellee first contends that possession of marihuana *per se* does not provide the basis for conviction of instant Federal offense nor of a violation under Section 4744 of Title 26, in the sense urged by appellant. To be a Federal offense under Count One, the marihuana must have been smuggled or imported contrary to law; while under Section 4744 of Title 26 it must have been acquired contrary to law. That is, the offense under Section 4744 arises from the avoidance of Federal tax or the failure to comply with the Federal tax laws, as distinguished for instance from a State offense of possession of an article made contraband by state law.

Of course any claim that State law prohibits the possession of a particular article such as marihuana would not give an importer of that marihuana a license not to comply with Federal Customs laws under the guise of the privilege against self-incrimination assuming he could possess it in a State prior to importation. The importer's own wrong, that is, possessing an article made contraband by State law, would not make it right for him to disobey Federal Customs laws that have to be complied with by persons bringing into the United States such an article. It is well settled that the privilege against self-incrimination cannot be invoked Federally on the ground of self-incrimination under the laws of State jurisdiction. See *United States v. Eramdjian,* 155 Fed. Supp. 914-925 (D.C. S.D. Cal., 1957) and *Reyes v. United States,* 258 F. 2d 774-778 (9th Cir. 1958). In the *Eramdjian* case Judge Carter exhaustively discussed the question of self-incrimination in connection with the registration requirements of Section 1407, Title 18, United States Code, and found it

did not violate the Fifth Amendment because registration might lead to State prosecution. In *Reyes,* this Court specifically adopted Judge Carter's opinion.

A contention was made to this Court in case No. 18,154, *Wilson v. United States,* that Section 4705(a) of Title 26, United States Code was unconstitutional as compelling a person to be a witness against himself. This Court on February 4, 1963 pointed out that this section requires the purchaser of the narcotics to sign the written order, not the seller, and indicated that the cases of *Russell v. United States,* 306 F. 2d 402 (9th Cir. 1962) and *United States v. Kahriger,* 345 U. S. 22 (1953), apparently relied upon by Wilson, were inapposite.

The *Kahriger* case states that the privilege of self-incrimination has relation only to past acts, not to future acts which may or may not be committed. The *Russell* case, pertaining to the requirement of every person of Section 5841 of Title 26, to provide information (concerning firearms possessed) as to past conduct or present status which is actually or presumptively unlawful also seems inapposite to requirements which essentially pertain to future conduct, to wit: the presentation of invoices, entries and declarations concerning articles to be brought into the United States from a foreign country. It follows that even if such a declaration could be construed as constructive possession, such would certainly not be possession within the meaning of the holding in the *Russell* case. See Note 18, *Russell v. United States, supra.* Nor was this prosecution as to Rossetti based upon possession as to him. No instructions were given as to this appellant on the so-called statutory presumption in Section 176(a) upon

which appellant relies as establishing his point. Notwithstanding this, Rossetti while not suffering a conviction based upon the theory here advanced, seeks to be allowed to turn the Fifth Amendment into a sword to strike down by his own wrong doing the statute under which he was convicted.

Assuming *arguendo* that appellant has standing to raise this claim and further that compliance with the customs laws would tend in some way to incriminate an importer of marihuana, Federally, he would and should not be excused from compliance on that ground. See the *Eramdjian* and *Reyes* cases, *supra,* citing with approval at pages 927 and 781, respectively, *United States v. Dalton,* 286 Fed. 756 (D.C. W.D. Wash. 1923).

In the *Dalton* case defendants were indicted for smuggling merchandise (liquor) which was contraband by Federal law and claimed that since a declaration would compel them to incriminate themselves under the National Prohibition Act they could not be prosecuted for failing to comply with Customs laws. The Court stated at page 757:

> "It was incumbent on the defendants not only to declare the entry, but also to obtain a permit qualifying the goods for entry, and for having failed may not hide behind the Fifth Amendment when apprehended and evade penalty of the illegal act, and make a right out of two wrongs. The Fifth Amendment has no application where parties or goods seek admission into the United States, . . ."

VI.
CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the jury verdict of guilty in the court below should be affirmed.

Respectfully submitted,

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THOMAS R. SHERIDAN,
Assistant U. S. Attorney,
Chief Criminal Division,

ELMER ENSTROM, JR.,
Assistant U. S. Attorney,

Attorneys for Appellee.

CERTIFICATE.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

ELMER ENSTROM

APPENDIX A.

Indictment.

(U. S. C., Title 21, Sec. 176(a); U. S. C., Title 18, Sec. 2—Illegal importation of marihuana; Receipt and concealment of illegally imported marihuana; aiding and abetting.)

In the United States District Court in and for the Southern District of California, Southern Division.

January, 1962, Grand Jury—Southern Division.

United States of America, Plaintiff, vs. Joseph Patrick Kasamis, Pasquale Frank Crea, George Anthony Rossetti, Defendants. No. 30745-SD.

The Grand Jury charges:

COUNT ONE

On or about February 22, 1962, in San Diego County, within the Southern Division of the Southern District of California, defendant Joseph Patrick Kasamis, with intent to defraud the United States, knowingly smuggled and clandestinely introduced into the United States from Mexico approximately thirty-five pounds of bulk marihuana, which marihuana should have been invoiced, and knowingly imported and brought into the United States from Mexico said marihuana contrary to law, in that said marihuana had not been presented for inspection, entered and declared as provided by United States Code, Title 19, Sections 1459, 1461, 1484 and 1485; and defendants Pasquale Frank Crea and George Anthony Rossetti knowingly aided, abetted, assisted, counseled, induced and procured the commission of the aforesaid offense.

COUNT TWO

(U.S.C., Title 21, Sec. 176(a);
U.S.C., Title 18, Sec. 2)

On or about February 22, 1962, in San Diego County, within the Southern Division of the Southern District of California, defendant Joseph Patrick Kasamis, with intent to defraud the United States, knowingly received, concealed, and facilitated the transportation and concealment of approximately thirty-five pounds of bulk marihuana, which marihuana, as the defendant Joseph Patrick Kasamis then and there well knew, had been imported and brought into the United States contrary to law; and defendants Pasquale Frank Crea and George Anthony Rossetti knowingly aided, abetted, assisted, counseled, induced and procured the commission of the aforesaid offense.

A True Bill

/s/ Richard C. Adams
Foreman

/s/ Francis C. Whelan
Francis C. Whelan
United States Attorney

APPENDIX B.

The Following Excerpts Are Taken From the Reporters Transcript of Co-Defendant Kasamis at R. T. 43, 46, 47, 48. Direct Examination by the Government.

"Q. Mr. Kasamis, did you enter the United States in a 1952 Oldsmobile, green and black, on Thursday morning, February 22, 1962? A. I decline to testify on the grounds of the Fifth Amendment of self-incrimination. [R. T. 43.]

* * *

The Court: I will direct the witness to answer the question. Will you repeat the question? [R. T. 46.]

(The question was read.)

Mr. Steward: For the record, Your Honor, I will object to the question on the ground stated earlier outside the presence of the jury, if I may make reference to that.

* * *

The Witness: The answer to the question is: yes, I did.

By Mr. Enstrom: [R. T. 47.]

Q. Did you open the trunk of that vehicle for a Customs official at that point? [R. T. 83]

* * *

The Witness: At the time I was stopped at the Border?

The Court: Yes.

The Witness: Yes, I did open it.

By Mr. Enstrom:

Q. When did you receive the keys to that automobile which you were then operating?

* * *

The Witness: Yes, I received the keys on Thursday; on Thursday. [R. T. 48]

Q. That same Thursday. A. February 22nd, I believe; Thursday."

No. 18,257

IN THE

United States Court of Appeals

For the Ninth Circuit

RAYTHEON COMPANY, a corporation,
Appellant and Cross-appellee,

vs.

RHEEM MANUFACTURING COMPANY, a corporation, and RHEEM SEMICONDUCTOR CORPORATION, a corporation,
Appellees and Cross-appellants.

Brief of Rheem Manufacturing Company and Rheem Semiconductor Corporation as Appellees and Opening Brief as Cross-Appellants

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SUBJECT INDEX

TABLE OF CASES

STATUTES AND RULES

TEXTS

No. 18,257

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Invoking the diversity jurisdiction of a federal court on what is purely a contract case controlled by California law (*Erie R. R. Co. v. Tompkins*, 304 U.S. 64), plaintiff Raytheon Company

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All emphasis in quotations in this brief has been added unless otherwise noted.

The record is in 6 volumes. Vol. I is paged from 1 to 136. Volumes II through VI are reporter's transcripts, and, since the paging begins again in Volume II, we shall refer to pages in Vol. I as "R. ", and to pages in Vols. II-VI as "R. Tr. ".

(hereafter called "Raytheon") sued defendants Rheem Manufacturing Company and Rheem Semiconductor Corporation for declaratory relief. It now appeals from most of the judgment. So far as the portions from which it appeals are concerned, this is a fact case controlled by the findings of fact which are fully supported by the evidence. Consequently, Raytheon's appeal seeks to substitute this Court for the trier of the facts. For example, not only does it ask the Court to draw factual inferences from the record contrary to those of the District Court,[1] but it states as fact its own witnesses' versions of conversations and occurrences although the District Court accepted a different version given by appellees' witnesses. Our own statement of the case is therefore in order.

STATEMENT OF THE CASE

A. The Facts.

The issues in this case are issues of interpretation of a lease from Rheem Semiconductor Corporation to Raytheon dated November 30, 1961 made pursuant to a contract between them dated November 1, 1961.[2]

1. PROPER DESIGNATION OF THE PARTIES.

Raytheon's brief refers to Rheem Manufacturing Company as "Rheem". This is both confusing and misleading. It is confusing because the contract and lease use "Rheem" to designate Rheem Semiconductor Corporation (see R. 10), and in the key passages from those instruments quoted extensively in Raytheon's brief

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1. Drawing inferences of fact is the province of the trial court. Such inferences are themselves fact, and findings thereon are, like any other findings, controlling unless clearly erroneous. *United States v. Fotopulos,* 180 F.2d 631, 635 (9 Cir.); *Walling v. General Industries Co.,* 330 U.S. 545, 550; *Widney v. United States,* 178 F.2d 880, 884 (10 Cir.).

2. The contract is referred to as the "basic contract", and Exhibit 1 to the complaint is a copy. A form of the lease is attached as Exhibit B to the basic contract. A lease in that form was later executed as a separate document (R. Tr. 203, 204), but the copy referred to by the parties in this litigation is the form attached to the complaint at R. 53-60.

(at pp. 7-9) "Rheem" is used in that sense. It is misleading because the essence of Raytheon's appeal is an effort, however phrased, to disregard the corporate entity of Rheem Semiconductor Corporation as separate and distinct from Rheem Manufacturing Company. In this brief we shall refer to Rheem Manufacturing Company as "Manufacturing" and to Rheem Semiconductor Corporation as "Semiconductor".

2. RAYTHEON CONTRACTED WITH SEMICONDUCTOR AS AN ENTITY DISTINCT AND SEPARATE FROM ~~SEMICONDUCTOR~~ Manufacturing

The starting point is that Raytheon with full knowledge of the facts deliberately contracted with Semiconductor as a corporate entity distinct and separate from Manufacturing.

Semiconductor is a California corporation (R. 2) formed in 1959 (R. Tr. 463) to manufacture certain electronic devices with a plant at Mountain View, California. As organized, about 60% of its stock was owned by Manufacturing and 40% by certain scientific employees of Semiconductor known as the Baldwin Group. In 1960 negotiations between Manufacturing and Raytheon explored various business relationships and in 1961 explored purchase by Raytheon of Manufacturing's stockholdings in Semiconductor (R. Tr. 240, 241; also 61, 62). At the outset Raytheon was told the exact situation as to ownership of Semiconductor's stock, shown the stock records and the state of the accounts between Semiconductor and Manufacturing disclosing the moneys advanced by and owing to the parent (R. Tr. 242, 243; also 84). For reasons of its own, Raytheon decided not to deal with Manufacturing or to buy the shares but, beginning in September, 1961, to deal with Semiconductor for purchase of its assets (R. Tr. 63). Raytheon regarded employment of the Baldwin Group as a necessary condition of any deal (R. Tr. 84), and it was told that before a contract was entered into Manufacturing would acquire the stockholdings of the Baldwin Group, and before the basic contract was executed was told that Manufacturing had done so and owned 99.9% of Semiconductor's stock (R. Tr. 242,

243; also 84). With this full knowledge, Raytheon contracted with Semiconductor as a distinct and separate corporate entity. The testimony of Raytheon's officials to this effect is set out at pp. 35, 36, infra, and the District Court found (Finding 19, R. 161):

> "On and before the Basic Contract was entered into Raytheon was informed and knew that Rheem Manufacturing owned practically all of Rheem Semiconductor's stock but nevertheless contracted with Rheem Semiconductor as a distinct and separate corporate entity."

3. THE COURSE OF NEGOTIATIONS WITH RESPECT TO PRICE.

It was Raytheon's private purpose to try to acquire Semiconductor's essential assets for less than half their current book value[3] (R. Tr. 87). Semiconductor and Raytheon readily arrived at a price for Semiconductor's inventory, which is no part of the controversy. As to Semiconductor's fixed assets, consisting of equipment installed and operating as a full plant, the negotiations took the following course.

Those assets had been acquired between 1959 and the date of the contract, some in 1961 (R. Tr. 463), and had a book value as of June 30, 1961 of $2,177,088 (D. Ex. O, R. Tr. 453, 454). Semiconductor offered these assets to Raytheon at 90% of their book value, or $1,959,300 (R. Tr. 244). Raytheon rejected that offer and made a counteroffer of $850,000, which Semiconductor rejected out of hand (R. Tr. 96).

Meanwhile, Raytheon sent a team of accountants, a lawyer, and scientific men to Semiconductor's plant at Mountain View where they spent two weeks (R. Tr. 163, 462, 468), and Raytheon compiled a list of certain of the assets (R. Tr. 156, 157) of a book value of $941,141 (D. Ex. O). Semiconductor and Raytheon agreed to Raytheon's purchase of this list for $881,000 (R. Tr. 96, 97, 237). These assets have been called the "A List" or the "List A" assets.

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3. Cost less depreciation.

Semiconductor renewed its offer of the remaining assets, which have been called the "List B" or "B List"[4], to Raytheon at 90% of book value, and this Raytheon rejected (R. Tr. 97), offering in turn 30% of book (R. Tr. 100-102). It justified this absurdly low offer by stating that it had no use for these assets, that it had just bought the assets of Columbia Broadcasting System Electronics Company (hereafter called CBS) for less than 30% of book value and had all kinds of duplicate equipment as a result, and it belittled both the value and its need for the List B assets.[5] Semiconductor rejected this offer of 30%. Raytheon's chief negotiator (Oldfield) told Semiconductor's chief negotiator (Mallatratt):[6]

> "that there was no question but that these assets, so far as he could tell, might properly be worth the value that was shown on the book value to someone, but because of the excess of available assets from others, it was not worth that figure to Raytheon Company." (R. Tr. 246)

Oldfield suggested that Raytheon lease the List B assets for 6 months to evaluate them. But he said that he could not see that Raytheon then or later would be interested in buying any significant amount (R. Tr. 246), that "it would be much easier to proceed in these negotiations if we would not attach any significant value" to them (R. Tr. 245), and, in effect, that Raytheon would be doing Semiconductor a favor should it buy any of List B at a distress price (R. Tr. 238).

Privately, Raytheon considered items on the B list as essential, some very important (R. Tr. 69, 160, 161, 169, 170). Processes

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4. The meaning of "A List" and "B List" was stipulated (R. Tr. 140).

5. Raytheon had in fact just bought CBS's semiconductor equipment (R. Tr. 69) for less than 30% of book (R. Tr. 100, 101). Mr. Oldfield, Raytheon's vice-president and chief negotiator (R. Tr. 60, 61) and the man who signed the basic contract for it (R. Tr. 81) told Semiconductor's negotiator that due to the CBS acquisition List B would be surplus (R. Tr. 514).

6. Mr. Mallatratt, Semiconductor's Treasurer (R. Tr. 203) was its chief negotiator (R. Tr. 361, 513), assisted by Mr. Stroup (R. Tr. 483, 484).

at the Mountain View plant were different from those at Raytheon's East Coast plants, and the operations at Mountain View required specialized equipment (R. Tr. 170, 171). The Mountain View plant was beautifully adapted to its purpose, it had taken a considerable degree of sophisticated engineering and scientific judgment to design it, its processes were advanced (R. Tr. 319, 320). Mr. Oldfield admitted at the trial that the B list equipment had been especially adapted to operations at Mountain View and many of the items were required for production there (R. Tr. 106).

During the negotiations in October 1961, shortly before the contract was signed, Mr. Mallatratt heard a rumor that one of Raytheon's officials had boasted that Raytheon had "rooked" CBS and that what it had done to CBS was nothing compared to what it was going to do to Semiconductor. Mr. Mallatratt spoke about this to Mr. Oldfield, half jocularly, half seriously, and Mr. Oldfield denied the rumor (Oldfield, R. Tr. 65). Later events brought this rumor back to mind (see p. 12, infra).

4. THE LEASE, THE OPTIONS, AND THE SUBSTITUTION CLAUSE.

The parties then inserted into the contract a provision that Raytheon would lease the List B assets for six months from December 1, 1961 (Art I, Sec. 2(a), R. 12; Lease, R. 53). Prior to May 15, 1962, Raytheon would have the option to buy any of the leased assets at a price to be agreed between the parties, or, failing agreement, at either 90% of the June 30, 1961 book value or the fair market value as appraised by American Appraisal Co., whichever was *lower*. A semi-final draft of the contract prepared on October 26, 1961 by the attorneys for the two sides (R. 363) contained a clause committing Raytheon to buy at least $250,000 of the leased assets, but a day or two before execution[7] Raytheon said that *it did not want to be committed* and asked that this clause go out, and it was deleted (R. Tr. 364).

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7. The basic contract was executed on November 4, 1961 (R. Tr. 361).

Thus Raytheon remained endowed with an option but free of any commitment. Raytheon's efforts throughout were, as we shall see, to put itself in a position where Semiconductor would be bound while Raytheon had rights without commitments.

As part of the hard bargain Raytheon was driving, it obtained a right of substitution (Basic Contract, Art I, Sec. 2(b), R. 12). Under it, until December 15, 1961, Raytheon could substitute for any item on the A list, which it had bought, an item on the B list of the same or greater book value.

Semiconductor realized that it needed some protection against what would otherwise be a wholly one-sided contract. Without more, Raytheon's right of substitution and option to buy could leave Semiconductor unprotected to Raytheon's rapacity, if rapacious Raytheon should prove to be. With the right of substitution, should Raytheon find that it did not want any item it had bought, or did not want it at the price it had agreed to pay, or that it had declined in value,[8] or if it found choice items on the leased list that it preferred, it could substitute, thereby insuring that it obtained the choicer items and relegating the supplanted items to the B list. Then, with its option it might still pick up the supplanted items for less than 90% of book value although it had originally agreed to buy them at that price, and it could "skim the cream" or "cannibalize" the B list. Until May 15, 1962 it could select out key pieces of equipment, or break up full lines of equipment. The remainder could be of depressed worth to an outside purchaser to whom they would be but odds and ends. But to Raytheon they would not be odds and ends but part of a complete installation at the Mountain View plant and of utmost value. By exercise of the option, if unqualified, Raytheon might thus place itself in a position of being able to compel Semi-

8. Electronics technology develops so fast that equipment could become obsolete rapidly (R. Tr. 193).

conductor to sell to it for a song while consistently committing itself to buy nothing.[9]

Consequently, Semiconductor asked for a further provision in the lease, a provision that if during the first 90 days of the lease term (i.e., until March 1, 1962) Semiconductor should have received an offer for any items of the leased property, Raytheon's option would be *limited* to the right, within 5 days of notice, to purchase the items at the price specified in the offer, and, in the event Raytheon should not exercise this right of first refusal, Semiconductor would be free to sell the items to the offeror at the offered price. This was agreed to.

It was fully understood at the time that Manufacturing might make an offer to Semiconductor for items on the B list. It had been negotiating with Japanese interests to set up a semiconductor division in Japan, possibilities for use in Greece were considered, and inquiries had been received from Stanford Research Institute about acquiring a full line of equipment (R. Tr. 212-214, 217, 233, 254). During the negotiations Mr. Mallatratt had told Mr. Oldfield and Mr. Kather, another vice-president of Raytheon, General Manager of its semiconductor division and one of its negotiators (R. Tr. 81, 139), about these possibilities of use of the equipment (R. Tr. 134, 135). Before the basic contract was executed and during "the discussion concerning the term of the lease and the right of first refusal" Mr. Mallatratt also told Mr.

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9. The District Court spontaneously saw the significance. For example, it commented (R. Tr. 259):

> "THE COURT: Mindful of the intensity of the volatile nature of the particular industry, what would occur if an item should prove to be antiquated or otherwise supplemented by some new advance in the industry to the extent that—let us take Item X, for the purpose of illustration. Let us assume that Item X, mindful again of the volatile nature of this particular industry, became or was superseded by some advance in the science of the arts, then could there be a substitution under A and relegated to B?"

Again (R. 261): "Where was the gamble from Raytheon's viewpoint if they could make substitutions willy-nilly?"

Kather and Mr. Oldfield that Manufacturing itself might make an offer to Semiconductor for some of the List B assets (R. Tr. 515), and either Oldfield or Kather acknowledged that they understood that Manufacturing might do so (R. Tr. 516). Then, at one of the last negotiating meetings, Mr. Mallatratt and Mr. Stroup explained to Kather that they hoped to establish "a number of manufacturing lines abroad in various countries" and "Mr. Kather made the remark that now he understood why we chose to keep the surplus assets rather than dispose of them at a low price." (R. Tr. 517)

Immediately before the contract was executed, Raytheon's counsel in a telephone call concerning various details asked that the word "bona fide" be inserted before the word "offer" in the first refusal clause without stating that there was any purpose to preclude a possible offer by Manufacturing (R. Tr. 365). The words were inserted, so that as executed Section 12 of the lease prescribed the right of first refusal thus (R. 57):

> "12. *Right of First Refusal:* In the event that, during the first ninety (90) days after the commencement of the term of this Lease, Lessor shall have received a bona fide offer for any item or items of the Leased Property, Lessee shall have the right within five (5) business days from the date on which notice of such offer (specifying the price or prices offered) is communicated to Lessee at its Mountain View plant facility to purchase from Lessor such item or items of the Leased Property at the price or prices, as the case may be, specified in such offer. In the event Lessee exercises such right, the item or items of Leased Property shall be conveyed to Lessee by Lessor. In the event that Lessee does not exercise such right within such five (5) business days or indicates its desire not to so exercise, Lessor shall have the right to sell, subject to the remaining term of this Lease, such item or items to the party making such offer at the price or prices, as the case may be, offered by such party as set forth in said notice."

The Trial Court found (Finding 21, R. 161):

> "21. During the negotiation of the Basic Contract and the lease and prior to their written execution Raytheon was informed by Rheem Manufacturing and Rheem Semiconductor that Rheem Manufacturing might make an offer to Rheem Semiconductor during the term of the lease for some of the leased assets. The words 'bona fide' appearing before the word 'offer' in paragraph 12 of the lease quoted above were thereafter added at the request of Raytheon, after the Basic Contract had been executed, by an agreement of additions and corrections without any advice by Raytheon that its purpose was to preclude an offer by Rheem Manufacturing. Raytheon did not intend by those words or otherwise to preclude an offer by Rheem Manufacturing to Rheem Semiconductor, and Rheem Semiconductor did not by agreeing to include those words, or otherwise, intend to preclude itself from receiving or accepting an offer from Rheem Manufacturing."

5. RAYTHEON'S EXTENSIVE EXERCISE OF THE RIGHT OF SUBSTITUTION AND THE CONSEQUENT SITUATION CONFRONTING SEMICONDUCTOR IN JANUARY 1962.

The contract gave Raytheon until December 15th to exercise its right of substitution. Before December 15th Mallatratt, at Oldfield's request, granted an extension of that time.[10] When the substitutions were completed in January 1962 their *extent was a shock to Semiconductor.* As much as 30% of the List A items, which

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10. Raytheon's witnesses denied that there was any such extension, but Mr. Mallatratt testified that there was (R. Tr. 248, 249), as did Mr. Stroup (R. Tr. 518). And in his deposition taken a few days before the trial Mr. Oldfield admitted that an extension had been granted (R. Tr. 104), and that Raytheon was exercising the right of substitution into January 1962 (R. Tr. 104). Obviously all conflicts on relevant matters have been resolved by the judgment against Raytheon. And the documents show that substitution was in fact not completed until well in January. A wire of December 15, 1962 contained errors (R. Tr. 332), a correcting wire was sent on December 21st (R. Tr. 333), a revised List A was sent on December 28th (R. Tr. 328-333) but this erroneously contained many items never on the B list (R. Tr. 340, 341), the matter was not clarified for some time (R. Tr. 340), and not until January 20, 1962 did Mr. Mallatratt and Mr. Oldfield finally agree on the final substitution list (R. Tr. 144, 159, 349).

Raytheon had originally agreed to buy, it supplanted by what it felt were choicer items from the former B list (R. Tr. 159). Semiconductor protested by letter of January 10, 1962 (Def. Ex. I).[11] It pointed out that Raytheon had prepared the A List and said:

> "We have always proceeded on the assumption that your engineering department knew what it was doing when it compiled original Exhibit A and, since the substitution provisions of paragraph 2(b) were agreed to only for the purpose of allowing you to correct minor errors which you had made in compiling Exhibit A originally, we would assume that the greater bulk of the items on revised Exhibit A are the same items which were originally designated. Under those circumstances, the net changes should have been minimal * * *."

Raytheon replied on January 16th (Def. Ex. J)[12] admitting that it "is quite true that Raytheon initially prepared Exhibit A as it appears in the Agreement itself" but insisting:

> "The substitution provisions of paragraph 2(b) were not for the purpose of allowing us to correct minor errors but to permit us to change our mind as between Exhibit A and Exhibit B items. There was no understanding, express or implied, that this would be limited to minor exchanges. On the contrary (although I don't believe that this is the case) we had a perfect right to substitute for the entire list."

Since the contract had been drawn up by trained lawyers on each side, and nothing in its language limited the scope of substitution, whatever Semiconductor believed the purpose of the substitution clause to be, Semiconductor had no choice but to succumb to Raytheon's position. It accepted the revised A list on January 22nd (Def. Ex. K).[13]

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11. Introduced at R. Tr. 345.

12. Introduced at R. Tr. 347.

13. Introduced at R. Tr. 349. Raytheon never paid a cent more to Semiconductor as a result of the substitutions (R. Tr. 339).

The essence of the present suit and appeal is that with the shoe on the other foot Raytheon asks the Court to revise the option clause for its benefit to place limitations in it that are not expressed.

Throughout all November and December, 1961, and to the middle of January, 1962, Raytheon could have, at any time it wished, obtained title to any of the items on the B list by exercising its option. But it had not exercised that right (R. Tr. 165, 166), *because it did not wish to commit itself to anything whatever.*

At this juncture something occurred to recall the rumor of the previous October that Raytheon intended to "rook" Semiconductor. Raytheon privately had been calculating on picking up the B list assets, of a book value of close to $1,200,000 (See Def. Ex. 0),[14] for a paltry $280,000, or after applying the $250,000 rental, an added payment of only about $30,000 (R. Tr. 175). In the week ending January 10, 1962 (R. Tr. 149) Mr. Kather of Raytheon talked to Mr. Oesterle, one of Manufacturing's accounting employees, who had been lent to Semiconductor to coordinate record keeping at Mountain View in the transition to Raytheon operation (R. Tr. 462). Mr. Oesterle had no authority whatever to negotiate any sale of items on the B list (R. Tr. 422, 463, 527, 528). But Mr. Kather said to him that Raytheon might be willing to buy the whole B List[15] for $350,000 or possibly, if pushed, $385,000 (R. 150, 151, 177). This was another shock, for even the top figure constituted but 23% of cost and 30% of the book value as of June 30, 1961, which Semiconductor had rejected in the negotiations of the previous October. Mr. Kather, gathering the idea that Oesterle was receptive (R. Tr. 152), was so delighted that he at once "jubilantly" reported to Mr. Oldfield (R. Tr. 152), his superior (R. Tr. 156).

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14. Introduced at R. Tr. 454.

15. Not just the portion of the B List later involved in Manufacturing's offer but the whole list (R. Tr. 177).

The situation now confronting Semiconductor and Manufacturing was this. Raytheon appeared to be acting to the end of cannibalizing the B List and thereby impairing the value of the remaining assets (R. Tr. 220, 221, 223), as it was in a position to do. These fears were underscored by Kather's suggestion of the paltry $350,000 to $385,000. Moreover, with the substitution completed in January, the A and B lists had become final, and for the first time Semiconductor knew what was sold outright to Raytheon and what was leased; for "the first time * * * we could look at the picture realistically in terms of what was available" (R. Tr. 518, 519). Even so, it did not yet know what Raytheon might still elect to buy. Yet it had to know, in order to know what would be available for disposal elsewhere. As noted, there had been negotiations with the Japanese and consideration of uses in other foreign countries or in Manufacturing itself, and inquiries from Stanford Research Institute (See p. 8, supra, also R. Tr. 212-214, 217, 233, 234, 254, 490). But if Raytheon's option rights continued outstanding and unexercised, with Raytheon uncommitted, Semiconductor would be in the position of having to wait for the second shoe to drop, injuriously delayed until May 15th in knowing what equipment would be available for sale (R. Tr. 520, 521). The Japanese negotiations would continue to be frozen (R. Tr. 379, 508, 509). In order to be able to plan properly it was necessary to know what Raytheon was going to take in the teeth of its oft-repeated statements of disinterest (R. Tr. 221).

Manufacturing therefore decided to make an offer to Semiconductor for some of the B list. Mr. Mallatratt summed up one of the reasons motivating him in his testimony (R. Tr. 252, 253) that he had "in mind at the time that if Raytheon were to exercise an election to pick select items, it would then be in a position to buy the remainder at a depressed value" and thus "still be in the position to have the whole, but at a depressed price", and that "one of the purposes in Manufacturing making the offer was to

* * * prevent the consequences on value of cannibalization of the equipment". This has been described as a "stop loss approach" to the situation (R. Tr. 211).

6. THE STROUP-KATHER CONVERSATION OF JANUARY, 1962.

Manufacturing decided to make an offer to Semiconductor, but, before doing so, Mr. Stroup of Manufacturing telephoned Mr. Kather of Raytheon on January 12, 1962 (R. Tr. 523). Kather's version of this conversation (R. Tr. 154) differs from Stroup's (R. Tr. 523-525). Raytheon's brief gives this Court Kather's version (Br. 10, 11), but the trial court believed Stroup's, which must therefore be taken on this appeal as correct. Stroup informed Kather that Manufacturing was about to submit an offer to Semiconductor on some of the B list assets (R. Tr. 523, 524), as "of course", he said, "Rheem Manufacturing Company has the right, as we discussed in Massachusetts" (during the October negotiations, pp. 8, 9, supra), and Kather affirmed that that was so (R. Tr. 524, 525). The trial court found (Finding 22, R. 162):

> "22. On January 12, 1962, Rheem Manufacturing advised Raytheon that in accordance with its right to do so it intended to make an offer to Rheem Semiconductor for some of the leased assets and Raytheon acquiesced that Rheem Manufacturing had such a right."

Stroup went on to say to Kather in the conversation that Manufacturing would defer submitting an offer to Semiconductor to permit Raytheon to negotiate with Semiconductor for any of the equipment it wanted (R. Tr. 524).

Raytheon was thus given the opportunity to come in and finally commit itself to buy *what it wanted, if it wanted,* at fair market value. *It did not do so.* Some days later Kather telephoned to Stroup that Raytheon was *not* prepared to negotiate (R. Tr. 525).

Not until then did Manufacturing make its offer to Semiconductor (R. Tr. 525).

7. MANUFACTURING'S OFFER, BASED ON AN APPRAISAL OF FAIR MARKET VALUE AND FOUND BY THE DISTRICT COURT TO BE LEGITIMATE AND REACHED IN GOOD FAITH.

At the first hearing in the court below the District Judge initially was impressed by the appellation that Manufacturing's offer was a "rigged bid" (R. Tr. 649). But the facts quickly dispelled that description and, in the court's later words (R. Tr. 182), were an "enlargement of the perspectives". Had there been an intention of forcing Raytheon to buy at an unfairly high price or to buy all in order to buy any, Manufacturing would have made an offer on the whole B list at an inordinate price.

Instead, in order "to obtain a fair independent appraisal of a fair market value of the assets involved" (Mallatratt, R. Tr. 209), on January 12th (R. Tr. 295, 296), the day Stroup telephoned Kather, Manufacturing engaged the services of an expert in the machine-tool and equipment field, Mr. Ellison of the firm of Harron, Richards & McCone of Northern California (R. Tr. 269, 311-312) to appraise the "true fair market value" (R. Tr. 296, 495) of the items on the B list. Section 12 of the lease, which uses the words "fair market value", was read to Mr. Ellison (R. Tr. 373). Moreover, Mr. Ellison was asked by Manufacturing to be *conservative* in his appraisal, to be on the low and not the high side, because he might himself be asked to submit a bid for some or all of the items later (R. Tr. 298). In consequence the appraisal that Ellison eventually came up with "was substantially influenced on the downward side" by Manufacturing's caution (R. Tr. 304, 305). Mr. Ellison was called as a witness by Raytheon itself, and the District Court remarked that it was impressed with Mr. Ellison's integrity and the fact that he is "a very, very fine, well versed man in his field." (R. Tr. 628.)

Starting with a list (R. Tr. 271, 297) Mr. Ellison inspected the equipment at the Mountain View plant (R. Tr. 297). In consequence, he divided the List B assets into two groups. One group

comprised what appeared to be highly specialized, single purpose items related primarily to the Mountain View plant, not easily removed and resold to someone else, and which therefore would sell to others for a smaller fraction of acquisition cost. These Mr. Ellison placed in Group 2. The others, which he put in Group 1, were the items "which could be used in a more general way and on a broader base" (R. Tr. 286, 290; see also R. Tr. 491, 494, 503).[16]

Mr. Ellison stated three different values for the *whole* B List, depending on the standard applied, as follows:

1. $1,750,000:—"the value to Raytheon, in not having those assets taken away from the use to [in] which they had them and so that they wouldn't be required to go out and replace the equipment" (R. Tr. 306:6-11; R. Tr. 307:4).

2. $400,000 or $500,000:—Ripped out of the plant, with full lines of equipment broken up, knocked down, $400,000 if sold to a liquidator for resale, the liquidator expecting to resell for at least 20% profit, or $500,000 if a direct sale could be made to one who had use for 30% or 40% of the items and would then try to liquidate the remainder (R. Tr. 300). This figure of $400,000 or $500,000 was "*not* fair market value; it was liquid value, lump value, or lot sale value, for which Rheem could have, in my opinion, sold the entire group of assets to one person such as a speculator, or liquidator, or someone, for resale" (R. Tr. 272, 273, also 277). This is what he meant in his written report by the $400-500,000 figure (R. Tr. 273).

3. $638,960:—The "**fair market value**" (R. Tr. 285, 308). This sum was made up of $547,760 on Group 1 and $91,200 on Group 2. (R. Tr. 285.).

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16. Mr. Ellison called Group 1 "schedule A" and Group 2 "schedule B". The two together constitute List B (R. Tr. 285, 290, 291). To avoid confusion with List A and List B we substitute the terms Group 1 and Group 2.

These values Mr. Ellison reported by telephone to Stroup (R. Tr. 307), and Stroup reported them to Manufacturing's management (R. Tr. 511). In fact, Mr. Ellison reported to Mr. Stroup that the true fair value was "considerably more" than $638,960, but he reduced it to that amount on Manufacturing's concern, as noted above, that he give a "conservative market value" (R. Tr. 304, 305). His final written report to Manufacturing was mailed on January 16, 1962, giving his "final considered appraisal of fair market value", as $547,760 on Group 1 and $90,200 on Group 2 (R. Tr. 308).

After receipt of Ellison's written report Manufacturing waited until Kather telephoned Stroup that Raytheon was not interested in negotiating. Then, on January 17, 1962, Manufacturing made a written offer to Semiconductor for the Group 1 assets in exactly the amount of Ellison's appraisal of fair market value, viz., $547,-760.00, subject to Raytheon's right of first refusal, accompanied by a check for 10% as a deposit (Pl. Raytheon Grant Ex. 7). Semiconductor accepted the offer, and on January 18th notified Raytheon of the offer and acceptance subject to Raytheon's first refusal right (Ex. 3 to complaint, R. 97).

On receipt of this letter Raytheon did not react that Manufacturing had no right to make an offer or that an offer by it was not "bona fide". On the contrary, on January 22nd, its counsel, Mr. Resnick, who had been one of the negotiators for Raytheon and the person to whom it had entrusted the task of writing the contract and lease (R. Tr. 116), telephoned to Mr. Walter Lewis, Counsel of Manufacturing, and said that Raytheon "wished more time to consider it" and "decide what to do" as its time would expire on January 23rd. He did not say that the offer was not *bona fide* or that the parent corporation could not make an offer (R. Tr. 378). Mr. Lewis orally agreed that Raytheon could have until January 29th (R. Tr. 376) and confirmed

this extension by letter the next day (Def's Ex. L).[17] Then, *as an afterthought,* Raytheon, searching for some escape from the terms of the lease, conceived the idea that, since Manufacturing was the parent of Semiconductor, an offer by it was not "bona fide". On January 23rd, Raytheon wrote to Semiconductor (Ex. 4 to complaint, R. 104), acknowledging receipt of the notice of January 18th and saying:

> "*This is to advise that such notice is of no effect in that an offer by your parent corporation cannot be treated as a 'bona fide offer'* and secondly in that it fails to specify the individual prices offered for each item of equipment. We will regard any sale to Rheem Manufacturing Company made pursuant to paragraph 12 on the basis of such notice as made in breach of our agreement and will hold you accountable for all damages resulting directly or indirectly from such breach."

After finding, as quoted above (p. 14), that on January 12th Raytheon acknowledged that Manufacturing had the right to make an offer, the Trial Court further found (Finding 22, R. 162):

> "Later, upon receipt of notice from Rheem Semiconductor of the first offer, Raytheon on January 22, 1962 requested an extension of time in which to decide what to do, and not until afterwards did Raytheon advise Rheem Semiconductor that it contended that the offer of Rheem Manufacturing to Rheem Semiconductor was not bona fide."

Before receiving Raytheon's letter of January 23rd, Semiconductor discovered that Mr. Ellison had included in his figure of $547,760 some unavailable items of equipment. He had used a copy of the equipment list given to Raytheon in October. Raytheon had compiled from that list a List A of items to buy, a List B of items to lease, and a List C of items it rejected for all pur-

17. Introduced in evidence at R. Tr. 377.

poses (R. Tr. 461). The List C consisted of sales office furniture, which was not even at Mountain View and was scattered throughout the United States (R. Tr. 430, 449).[18] Since Manufacturing's offer to Semiconductor called for delivery to it on the loading dock at Mountain View on June 1st (See P. Ex. 7), Semiconductor could not comply with the terms of the offer as respects the absent items (R. Tr. 449). When Mr. Grant, Semiconductor's vice-president (R. Tr. 403, 404) in charge of selling off its assets (R. Tr. 448; see Def. Ex. M, authority from the directors) discovered these facts (R. Tr. 425), he asked Manufacturing to change its offer to eliminate the non-deliverable items (R. Tr. 449), and Semiconductor and Manufacturing agreed to a rescission of the first offer and acceptance "in view of the unavailability of those items" (P. Raytheon Grant Ex. 8).[19]

Mr. Ellison was then asked for a reappraisal with the missing items omitted (R. Tr. 430). On the basis of his formula for reappraisal (R. Tr. 450), Manufacturing made a new offer in the reduced sum of $531,584 on January 26, 1962 (P. Raytheon Grant Ex. 9),[20] subject to Raytheon's right of first refusal. On accepting the second offer Semiconductor notified Raytheon by letter of January 26, 1962 (Ex. 5 to complaint, R. 106).

The original cost of these assets was $1,037,759 and the book value as of June 30, 1961 was $838,881 (D. Ex. O; R. Tr. 453). Manufacturing's offer was thus but 63% of book value.

At the close of the trial, with the evidence fresh in its mind, the Trial Court said (R. Tr. 628) that the offer by Manufacturing "was a legitimate bid predicated upon an appraiser's valuation which has not been disputed, and certainly not impugned"; the offer "was a fair bid under all the circumstances"; it was a bid made "in good faith". And in its Finding 15 it found (R. 160)

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18. List C's book value was about $25,000 (R. Tr. 430).

19. Introduced at R. Tr. 219.

20. Introduced at R. Tr. 225.

> "In fixing the prices specified in its two offers Rheem Manufacturing employed an independent appraiser, Mr. J. O. Ellison, to appraise the assets. He determined that the fair market value of the assets covered by the offer was $531,584, and Rheem Manufacturing's offer in that amount was based on that appraisal. Mr. Ellison is a man of integrity and well qualified to appraise the assets."

After its notice of January 26th to Raytheon, Semiconductor received Raytheon's letter of January 23rd. In its reply (Ex. 6 to complaint, R. 109) it referred to Raytheon's letter as denying validity of the notice of January 18th, assumed that Raytheon "will take the same position" with respect to the new offer, rejected that position, and, while regarding Raytheon's letter of the 23rd as a decision not to exercise its first refusal rights, recognized that Raytheon had through February 2nd to act, concluding:

> "If, however, you do not exercise your first refusal rights by the close of business on February 2, 1962, we shall consummate the purchase and sale arrangements with Rheem Manufacturing Company as scheduled in accordance with its offer of January 26, 1962."

8. RAYTHEON'S REPLY AND THE CONSUMMATION OF THE SALE TO MANUFACTURING.

On the last day, February 2, 1962, Raytheon wrote to Semiconductor (Ex. 7 to complaint, R. 112). It stated that it exercised its rights under Section 12 of the lease to purchase the items covered by Manufacturing's offer and that:

> "It is necessary that the price of the items hereby purchased be determined. As you know, it is our position that no bona fide offer has been received by you for any of the items listed and that the price will be determined pursuant to other provisions of the agreement."

On February 6, 1962, Semiconductor wrote to Raytheon that, since it had failed to exercise its right of first refusal within the allotted time, the sale to Manufacturing was complete (Ex. 8 to complaint, R. 115). Semiconductor wrote Manufacturing to the same effect (Pl. Ex. 14, R. 436) and asked for payment of the $476,808 balance of the purchase price. Manufacturing paid the balance in full on February 13th (Def. Ex. N, also R. 450-452).

Six days later Raytheon filed this suit.

9. THE DISPOSITION OF THE LIST B ASSETS NOT INCLUDED IN MANUFACTURING'S OFFER TO SEMICONDUCTOR.

Finding 23 (R. 162) shows what happened to the remainder of the leased assets, i.e., those not covered by Manufacturing's offer:

> "23. On February 2, 1962, Raytheon notified Rheem Semiconductor of its election under paragraph 12 of the lease to buy certain of the leased assets not covered in Rheem Manufacturing's offer. On April 10, 1962, Raytheon notified Rheem Semiconductor of its election under paragraph 12 of the lease to buy still more of the leased assets not covered in Rheem Manufacturing's offer."

These elections were effected by Def. Ex. D (R. Tr. 166)[21] and Def. Ex. E (R. Tr. 167). These two letters plus Manufacturing's offer covered most but not all of the leased assets (R. Tr. 169).

B. These Proceedings.

1. THE CONTROVERSIES ASSERTED IN THE COMPLAINT.

The complaint alleged and the answer admitted the basic contract, lease, and many of the letters referred to above. The com-

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21. Raytheon wrote two letters on February 2d, Ex. 7 to complaint concerning the items covered by Manufacturing's offer, and Def. Ex. D. We note this to avoid confusion.

plaint then asserted the existence of *two* controversies on which it sought declaratory relief. Defendants' answer admitted the existence of the two controversies and more explicitly stated them thus (R. 124):

(a) Was Manufacturing's offer to Semiconductor a valid offer? Raytheon claims it was not; defendants claim it was. If it was not, Raytheon became entitled to purchase the assets in question without regard to the amount specified in said offer. If it was, Raytheon was not entitled to purchase those assets except at the price specified in Manufacturing's offer and then only by exercising the right of first refusal by February 2, 1962.

(b) If Manufacturing's offer was valid, did Raytheon exercise its right of first refusal to purchase the assets at the price specified in that offer? Raytheon asserts that it did. Defendants assert that it did not and therefore had no right to purchase the assets at any price.

2. THE APPLICATION FOR INJUNCTIVE RELIEF AND THE ALLEGATIONS OF THE COMPLAINT THEREON.

In view of Raytheon's belittling of its need of the List B assets at the time it entered into the contract, of its effort in January to obtain them for less than 30% of book value, of Mr. Kather's statement to Mr. Stroup in January of no interest in negotiating for them, and of its refusal to meet Manufacturing's offer of $531,584, further allegations of the complaint are highly revealing. The complaint alleged, in summary (R. 6):

> That several hundred items on List B were processing machinery and equipment *essential* in fabricating semiconductors, and several hundred other items were electronic testing equipment *essential* to test semiconductors, that Raytheon was employing these items to fill contracts with the Department of Defense and industrial concerns, that it was not only *essential* to Raytheon that these products be delivered as scheduled but that the maintenance of steady pro-

duction was of great importance to the general public interest, that should it be required to replace the items serious disruption of its production lines would ensue with incalculable damage to it.

Raytheon therefore sought an injunction against the defendants' removing the property. The complaint alleged Raytheon's readiness to pay for the property on whatever basis the court decided, $531,584 if the court found Manufacturing's offer valid, and it offered to, and did (R. 120), post a bond in that amount.

Defendants' answer *admitted* these allegations (R. 124, 125). *Thus it is an admitted fact that Raytheon needed the equipment, that it is of great value to Raytheon, and fully worth the $531,584.*[22]

Later the court found (Finding No. 8, R. 159):

"8. Many of the leased items are installed in the Raytheon plant and were so as acquired from Rheem Semiconductor and are essential to the plant's operation."

On filing the complaint, Raytheon had obtained, *ex parte,* a temporary restraining order against the defendants' selling any of the assets or interfering with Raytheon's possession (R. 119-121). At the hearing on the application for injunction defendants pointed out that Raytheon's possession of the property under lease could not be disturbed until June 1st, and defendants asked for an immediate trial (R. Tr. 644-646, 656). The case was set down for trial in May 1962, and no interlocutory injunction ever issued.

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22. Indeed, Oldfield testified that the whole B list was being used in the plant (R. Tr. 67). So also this colloquy (R. Tr. 662):

"THE COURT: Well, it is quite obvious, Mr. Wheat, that these assets are not distressed value assets; they are assets that have a real potential so far as you are concerned, aren't they?

"MR. WHEAT: They are essential as far as we are concerned in more ways than just dollars."

3. THE FURTHER CONTROVERSY RAISED BY DEFENDANTS' COUNTERCLAIM.

As a counterclaim defendants alleged (R. 125, 126) that Raytheon's purpose was to acquire the leased assets at distress values, and that there was a third controversy requiring resolution by the court, viz: Raytheon not only contended that it was entitled to buy the assets at value to be appraised by American Appraisal Company but also contended

> "that the fair market value to be appraised is the value of the assets as removed from the premises and sold at distress or forced sale",

whereas Semiconductor contended

> "that if plaintiff is entitled to buy said assets at the fair market value as appraised by * * * American Appraisal Company, the fair market value to be appraised is the value of the assets in their present location and as part of plaintiff's operations * * *."

By its reply to the counterclaim (R. 136, 137) Raytheon admitted that a controversy existed as to the interpretation of the term "fair market value". The real nature of Raytheon's contention is shown by its brief in this Court. It asserts (Br. 46):

> "The value to Raytheon of the 'B' list items is a false criterion",

in other words, no element at all in determining value, because "Semiconductor could not offer for sale upon the market anything more than the equipment dismounted and on the loading dock" (Br. 45).

4. THE ISSUES, THE TRIAL, DECISION, FINDINGS AND CONCLUSIONS.

At the close of the trial in which 10 witnesses were heard and 25 exhibits received the court announced its decision on two of the three issues by an oral opinion (R. Tr. 626-629). The remaining issue it decided in a later written memorandum and order

and called on Raytheon to prepare findings and conclusions (R. 139, 140). Raytheon submitted its suggested findings and conclusions (R. 141-148), defendants submitted objections and proposed amendments to Raytheon's draft (R. 149-154), Raytheon filed objections to the proposed amendments (R. 155), and on June 4, 1962, the court made and entered its Findings of Fact and Conclusions of Law (R. 157-164).

(a) **First Issue:** When Section 12 of the lease provided that, if Semiconductor should receive a bona fide offer for any items of the leased property, it might sell to the offeror unless Raytheon should exercise a right of first refusal, did this preclude the offer by Manufacturing?

In its oral opinion the court decided this issue against Raytheon. It said that the contract and lease had been prepared by competent lawyers on both sides, and the court would not rewrite them (R. Tr. 626); the facts did not call for disregard of corporate entity; there was no fraud, no misrepresentation, no mistake and no situation of any need to disregard corporate entity in order to protect an innocent third party (R. Tr. 627). Manufacturing's offer "was a legitimate bid predicated upon an appraiser's valuation that has not been disputed, and certainly not impugned"; the offer "was a fair bid under all the circumstances", a bid made "in good faith" (R. Tr. 628).

The court's later Finding 17 found (R. 161):

> "Rheem Manufacturing's offer to Rheem Semiconductor of January 26, 1962, as well as its prior but rescinded offer of January 17, 1962, was a bona fide offer."

And Conclusion of Law No. 1 reads:

> "The offer from Rheem Manufacturing to Rheem Semiconductor was a bona fide offer and as such required Raytheon either to exercise its right of first refusal with respect to the items covered by the offer, or forego its option to purchase said items" (R. 163).

(b) **Second Issue:** Manufacturing's offer being valid, had Raytheon exercised its right of first refusal? This was the issue the court reserved, later deciding it for Raytheon. It is the subject of defendants' cross-appeal (See pp. 70-78 infra).

(c) **Third Issue:** What was the meaning of "fair market value" as used in the lease? In determining "fair market value", was the appraiser totally to disregard any element of value the equipment had to Raytheon by virtue of its location in the plant and by virtue of its existence as part of a complete operation, and was he simply to consider the value of the equipment as if it were broken up, dismounted, disassembled, knocked down and thrown onto the used equipment market? As correctly stated by Raytheon's counsel in the closing argument (R. Tr. 573), this issue of "the standard of appraisal" had to be determined regardless of the decision of the first two issues, because of Raytheon's election to buy most of the Group 2 assets, i.e., those not covered by Manufacturing's offer.

This issue the court also decided against Raytheon. It said (R. Tr. 628) that

> "fair market value certainly contemplates * * * that recognition be given to the use to which the article is placed, and I can't conceive that these assets, valuable as they are or invaluable, should be regarded as something to be dumped on the loading dock and therein appraised when we find that Raytheon has a valid and substantial use thereof."

The Court later formally found (Finding 25, R. 163):

> "25. Raytheon has a valuable and substantial use for all of said leased assets."

The subject is covered by Conclusion of Law No. 3, which provides that as to leased items not included in Manufacturing's offer to Semiconductor which Raytheon elected to purchase (Group 2), should the parties not agree on a price, the price should be determined by appraisal of American Appraisal Company, and:

"In making such appraisal the value to be appraised is the fair market value of the assets to Raytheon in their present location as part of Raytheon's operations." (R. 163)

C. The Judgment, Raytheon's Appeal, the Issues involved in That Appeal, the False Issues Discussed in Raytheon's Brief, and Summary of the Argument.

Judgment was entered on June 11, 1962 (R. 165-168) as follows:

1. **Paragraph 1** adjudged that Manufacturing's offer to Semiconductor was a bona fide offer and, as such, required Raytheon either to exercise its first refusal or to forego entirely its option to purchase the items involved (R. 165-166). From this adjudication Raytheon appeals (R. 169).

2. **Paragraph 2** adjudged that Raytheon's notice of February 2, 1962 (R. 112) exercised its right of first refusal, resulting in a binding contract between Raytheon and Semiconductor whereby title to the Group 1 assets of List B vested in Raytheon on February 2, 1962, and Raytheon became bound to pay $531,584 to Semiconductor by February 17, 1962 (R. 166). Raytheon does not appeal this, but defendants do by their cross-appeal which we discuss at pp. 70-78, infra. However, Raytheon purports to appeal from a portion of paragraph 2 with respect to a false and non-existent issue, as we show at p. 68, infra.

3. **Paragraph 3** adjudges that by Raytheon's letters of February 2, 1962 (Def. Ex. D) and April 10, 1962 (Def. Ex. E) Raytheon elected to buy the Group 2 assets of List B, the price to be determined by appraisal of American Appraisal Company if the parties could not agree on a price. All parties accept this part of the judgment, but Raytheon appeals (R. 170) from the remainder of paragraph 3, which provides (R. 167):

"In making such appraisal the value to be appraised is the fair market value of the assets to plaintiff Raytheon Company in the present location of said assets at the Moun-

tain View plant of plaintiff Raytheon Company as part of the operations of Raytheon Company."

4. **Paragraph** 4 reserved jurisdiction to resolve any further controversies that might arise in the application of the judgment, Raytheon appeals from this paragraph (R. 170), raising a false and moot issue (See p. 69, infra).

5. **Paragraph** 5 awarded costs to Manufacturing and Semiconductor (R. 167) pursuant to Conclusion of Law No. 5 (R. 164), which stated

> "Since defendants have prevailed on the issues requiring the taking of evidence, defendants are entitled to recover their costs."

Although in its "Objections to Proposed Findings and Conclusions of Law Submitted by Rheem" (R. 155-156), no objection was made to this, Raytheon appeals from this award of costs (R. 170). Since R.C.P. Rule 54(d) vests discretion in the trial court with respect to costs (and see 6 Moore's Federal Practice, 2d ed., Sec. 54.70[3] and [4]), we shall not discuss this issue further.

The captions in the argument below have been so worded that, read consecutively in the Subject Index, they constitute a summary of our argument.

Argument of Manufacturing and Semiconductor as Appellees on Appeal of Raytheon

I.

UNDER SECTION 12 OF THE LEASE, AN OFFER BY RHEEM MANUFACTURING COMPANY WAS A VALID OFFER REQUIRING RAYTHEON TO ELECT WHETHER TO EXERCISE ITS RIGHT OF FIRST REFUSAL.

A. The Nature of the Issue and of Raytheon's Contentions.

1. THE QUESTION IS ONE OF INTERPRETATION OF A CONTRACT, AND AN OPTION CONTRACT MUST BE STRICTLY CONSTRUED AGAINST THE OPTIONEE, HERE RAYTHEON.

Nothing in the laws of nature gave Raytheon a right to buy any of Semiconductor's assets or to buy them at one price instead of another. Any rights Raytheon has must be found in the contract, a contract carefully worked out and supervised by Raytheon's own capable counsel (see pp. 18, 25, supra). The question is purely one of interpretation of the contract and in the context of its negotiation.

Moreover, it is an elementary principle, as stated in 4 Williston on Contracts (3rd ed. 1961) p. 753, Section 620 (citing many cases), that:

> "Where contracts are optional in respect to one party, they are strictly interpreted in favor of the party bound and against the party that is not bound * * *"

Or as said in *McArthur v. Rosenbaum Co. of Pittsburgh,* 180 F.2d 617 (3 Cir. 1950), after quoting Williston, supra:

> "In an option the optionor is not bound beyond the point where the words of the option clearly and definitely bind him. Where, as in the present case, the words of the option are ambiguous, the optionor is not bound at all because the court cannot say to what obligation he is bound." (p. 620).

This is the law of California, *Hayward Lbr. & Inv. Co. v. Const. Prod. Corp.,* 117 C.A. 2d 221, 255 P.2d 473 (1953):

> "Since the optionor is bound while the optionee is free to accept or not as he chooses, courts are strict in holding an optionee to exact compliance with the terms of the option." (p. 229).

To the same effect are *Phillips Petroleum Co. v. Curtis,* 182 F.2d 122, 125 (10 Cir. 1950) and the cases cited on pp. 74-76, infra.

2. THE RATIONALE OF RAYTHEON'S CONTENTION THAT MANUFACTURING'S OFFER SHOULD NOT BE RECOGNIZED HAS SHIFTED AND VARIED BUT COMES TO REST ON DISREGARD OF CORPORATE ENTITY.

When Raytheon first conceived and advanced its contention in its letter of January 23, 1962 to Semiconductor that the offer was not "bona fide", it rested it *solely* on the fact that Manufacturing was Semiconductor's parent, for it said in that letter:

> "This is to advise you that such notice is of no effect in that an offer by your parent corporation cannot be treated as a 'bona fide offer' * * *" (See p. 18, supra).

In the complaint commencing this suit Raytheon described its contention in the same terms:

> "Raytheon asserts that the threatened sale from Rheem-Sub [Semiconductor] to Rheem-Parent [Manufacturing] is not bona fide but, on the contrary, is completely illusory, in view of the relationship which exists between Rheem-Parent and Rheem-Sub, as hereinabove described". (R. 5)

This is simply an argument that Manufacturing and Semiconductor must be considered as one;—in short, it is an attempt to disregard Semiconductor's corporate entity.

But the adjective "bona fide" preceding the word "offer" in Section 12 of the lease is not a device by which to work a disregard of corporate entity. As we see at p. 44 infra, a "bona fide offer" means neither more nor less than that an offer was in truth

made, not as a pretense or without intent actually to buy, not as a fraudulent representation. Patently Manufacturing's offer was a real offer. The offeror paid the offered price (p. 21, supra), and the very fact that Raytheon sought to enjoin Manufacturing from removing the assets recognized that the offer was a real offer which the offeror proposed to consummate unless prevented by the court. At the trial of this case Raytheon's counsel conceded that "on this subject of good faith * * * we [Raytheon] make no contention that Manufacturing * * * wasn't willing to pay to Semiconductor the amount specified." (R. Tr. 26). Counsel conceded that "the transaction was actual * * * it happened * * * there was an offer * * * it was accepted * * * the money passed" (R. Tr. 609:21-25).

Consequently, Raytheon's trial counsel retreated to the contention that the words "bona fide" added nothing at all to the contract, and that the result would be the same if those words were not there. Said he: "I think that the offer from Rheem to Rheem which was made would have been declared a nullity even in the absence of the descriptive words 'bona fide' " (R. Tr. 562:7-9). This was a forthright reliance on disregard of corporate entity, stripped of the mask of the words "bona fide".

But reliance on doctrines of disregard of corporate entity is so untenable that Raytheon's present counsel shy away from it. They say that the case does not require disregard of corporate entity (Br. 22) and that (Br. 26), "All of this is not to say that, under appropriate circumstances a bona fide offer could not have come from Rheem [Manufacturing Co.]". Thus present counsel profess to stake their case on the words "bona fide". They purport to find lack of bona fides in a perverse and distorted version of facts and circumstances (Br. 22-36) of which Raytheon had no knowledge at the time it denounced Manufacturing's offer as not "bona fide" and when it brought this suit,—in short, on a *post litem* lawyer's concoction (see pp. 52-55, infra). And yet, *on*

analyzing their reasons for urging that the offer was not bona fide, *it will be seen that they do rest on the fact that Manufacturing was the parent* (see pp. 49, 50, infra).

We discuss (1) whether there is any basis for disregarding the separate corporate existence of the two corporations, and (2) what may be conjured up out of the words "bona fide".

B. This Is Not a Case for Disregard of Corporate Entity for a Variety of Reasons. The Question Is Whether, as a Matter of Interpretation, the Parties to the Contract Intended to Preclude an Offer by the Parent.

1. DOCTRINES OF DISREGARD OF CORPORATE ENTITY ARE INAPPLICABLE WHERE THE REAL QUESTION IS ONE OF INTERPRETATION OF A CONTRACT.

Latty, Subsidiaries and Affiliated Corporations, Section 15, pp. 65, 66, cogently remarks:

> "In many cases, as above suggested, especially where the dispute is over an attempt to evade an agreement or a statute, the problem is largely one of interpretation."

In *Pullman's Palace Car Company v. Missouri Pacific Railway Company*, 115 U.S. 587, on the basis of contentions concerning *purpose* and *motive*, just as here, the plaintiff sought to disregard a corporate entity (see p. 596). The case was disposed of on demurrer, the Supreme Court holding that as a matter of interpretation of the contract plaintiff's case was without merit.

2. THE EXTRINSIC EVIDENCE RELEVANT TO INTERPRETATION SUSTAINS THE DISTRICT COURT'S FINDINGS THAT THE PARTIES AGREED THAT MANUFACTURING WAS NOT PRECLUDED FOM MAKING AN OFFER.

At pages 10, 14, 19, supra we quoted findings 21 and 22 (R. 161, 162) wherein the trial court expressly found that during the negotiations of the contract and lease *Raytheon was informed by Manufacturing and Semiconductor that Manufacturing might make an offer to Semicondoctor during the term of the lease for some of the leased assets, that Raytheon did not intend by the sub-*

sequent insertion of the words "bona fide" or otherwise to preclude an offer by Manufacturing to Semiconductor, and Semiconductor did not by agreeing to include those words, or otherwise, intend to preclude itself from receiving or accepting an offer from Manufacturing, that on January 12, 1962, Manufacturing advised Raytheon that *in accordance with its right to do so* it intended to make an offer to Semiconductor for some of the leased assets *and Raytheon acquiesced that Manufacturing had such a right,* and that Raytheon's present contention was an afterthought.

These findings are fully supported by the explicit testimony of Mr. Stroup and Mr. Lewis, reviewed at pages 8, 9, 14, 18, supra.

If the parties had mutually intended to preclude an offer by Manufacturing, particularly in the teeth of these conversations, they would have expressly so provided. As the court below said to Raytheon's counsel during the closing argument (R. Tr. 611-612):

> "THE COURT: Counsel—counsel, in the light of the conversations which are in evidence and not denied immediately prior to the execution of the contract, would you not regard it a provident act on the part of a careful and meticulous lawyer to incorporate a negative provision in the contract under such circumstances?
>
> "MR. WHEAT: My answer is 'yes,' but I do not quite understand. I don't think adding the word 'bona fide' as an adjective modifying the word 'offer' is negative.
>
> "THE COURT: It would have been a simple matter at the time to negative the possibility of a bid by the parent company, would it not?
>
> "MR. WHEAT: Oh, but there is—no question about it, that that is the last thing that anybody was going to be thinking about under the terms of these negotiations.
>
> "THE COURT: Counsel—Counsel, this is not a matter that rests now in the realm of speculation, conjecture or inference. There were plain, manifest discussions which had not been denied in this record concerning the probability, if not the prospect, of the parent company entering a bid. There

were at the time references made to the possibility of a Japanese enterprise, joint venture, if you please. * * * in terms of interpretation it seems elementary to me and certainly Hornbook law that the discussions having taken place immediately prior to the execution of the contract would put these highly skilled lawyers upon notice, and it seems to me that a provision could be incorporated therein."

Another item of extrinsic evidence is the conduct of the parties under Article VII, Section 4 of the basic contract (R. 44) before any controversy arose.[23] The date of closing of the contract was November 30th (R. Tr. 114), and Art. VII, Section 4 provided that Raytheon would reimburse Semiconductor for the amount by which disbursements exceeded receipts in the operation of the Mountain View plant between the effective date of the contract, November 1st, and the date of closing, and that Semiconductor would turn over to Raytheon the amount by which receipts exceeded disbursements. For the month of November Semiconductor paid interest to Manufacturing on loans. In the account Semiconductor submitted to Raytheon under Article VII, Sec. 4, it asked Raytheon to reimburse it for this interest, *and Raytheon did reimburse it* (Oldfield, R. Tr. 114, 115). If the corporate separateness of Manufacturing and Semiconductor were to be disregarded, if the two were to be considered but two "pockets" of one entity as Raytheon now contends (Br. 34, 40), Raytheon would not have had to reimburse that entity for moneys transferred from one pocket to another.

3. RAYTHEON KNOWINGLY CONTRACTED WITH SEMICONDUCTOR AS A CORPORATION DISTINCT AND SEPARATE FROM MANUFACTURING.

It is elementary that a corporate entity will not be ignored at the behest of one who has contracted with it as an entity, fully

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23. It is elementary that the contemporaneous construction by conduct of parties before a controversy arises is controlling in the interpretation of the contract. *Universal Sales Corp. v. Cal. etc. Mfg. Co.*, 20 C. (2d) 751, 761, 128 P.2d 665.

knowing about its stockholders, nor will it be ignored for the benefit of one who deliberately framed his business with respect to and in the light of the corporate organization, *Lynch v. McDonald*, 155 Cal. 704, 102 Pac. 918, which is cited by this Court to that effect in *Re John Koke Co.*, 38 F.2d 232, 233 (9 Cir. 1930). So also *Rashap v. Brownell*, 229 F.2d 193 (2 Cir. 1956). In *California Linoleum and Shade Supplies, Inc. v. Schultz*, 105 Cal. App. 471, 287 Pac. 980 (1930), plaintiff bought the assets and good will of a corporation which agreed not to compete with him in Los Angeles County. The complaint alleged that the defendant Schultz and two others had formerly done business as a copartnership, that they had then formed the corporation to conduct the business, "and that while it was in form a corporation, yet in truth and in fact it was a copartnership" (p. 473). Plaintiff's theory was that the corporate entity should be disregarded and that defendant Schultz should be held to have contracted individually not to compete with plaintiff in Los Angeles County. Judgment for defendant on sustaining a demurrer without leave to amend was affirmed because (pp. 473, 474) "plaintiff dealt with it [the party with whom he contracted] as a corporation" and "as stated before, the contract was with the corporation only and purported to bind it alone."

The record here plainly shows that Raytheon not only knew full well that Manufacturing owned essentially all of Semiconductor's stock but knew of the state of the accounts between them (p. 3, supra). Nevertheless, Raytheon chose to contract with Semiconductor as a separate entity, without writing into the first refusal provision of the lease any provision that the parent could not make an offer. Thus Mr. Oldfield, Raytheon's vice-president and chief negotiator (R. Tr. 60, 61) testified (R. Tr. 84):

> "Q. So, you understood, at the time you signed that contract on behalf of Raytheon, that Rheem Manufacturing

Company owned essentially 100 percent of Rheem Semiconductor stock?

"A. Or had it committed.

"Q. Yes. And when you negotiated that contract and executed that contract for the acquisition of assets and the lease of assets, you knew that you were dealing with Rheem Semiconductor as a separate corporate entity, did you not?

"A. Yes, we knew that our contract was with Rheem Semiconductor."

Again he testified (R. Tr. 86):

"Q. You knew then that you were talking about assets of Rheem Semiconductor Corporation and not Rheem Manufacturing Company?

"A. Yes, I did."

The contract contains a representation and warranty by Semiconductor (Art. IV, Sec. 6; R. 32-33) that

"(i) Rheem [Semiconductor] is a corporation duly organized, validly existing and in good standing under the laws of the State of California, (ii) Rheem [Semiconductor] has corporate power and authority to execute and perform this Agreement and to consummate the transactions herein contemplated * * *"

The contract also provided (Art. V, Para. 2(f), R. 37) that Raytheon would not be bound to consummate the agreement unless at its option it received from Semiconductor's counsel an opinion on the closing date to the same effect and in the same words as this warranty. Mr. Resnick, Raytheon's counsel in the negotiations and the author of the written expression of the contract and lease (R. Tr. 350), testified that he insisted on this warranty by Semiconductor that it was a valid corporation (R. Tr. 351) and on the requirement for an opinion by counsel (R. Tr. 353), and that (R. Tr. 352) *"The contract is written with Rheem Semiconductor. Q. As a corporation? A. Yes."*

Before closing Mr. Resnick demanded and received from Semiconductor's counsel the required opinion (R. Tr. 353).

4. NOR ARE ANY OF THE OTHER ELEMENTS ESSENTIAL TO A DISREGARD OF CORPORATE ENTITY PRESENT, AND THE TRIAL COURT'S FINDINGS TO THAT EFFECT ARE CONCLUSIVE.

This Court in *Re John Koke*, 38 F.2d 232, 233 (9 Cir.) also stated:

> "The rule is quite elementary that a corporation is an entity separate and distinct from its stockholders, with separate and distinct rights and liabilities; and this is true even though a single individual may own all, or nearly all, of the capital stock. True, courts, in exceptional cases, will look behind the corporate form in order to redress fraud, protect the rights of third persons, or prevent a palpable injustice; but there is no reason for invoking any such exceptional rule here, because it is not claimed that there was fraud, concealment, or even ignorance of any material fact in the original transaction."

It is elementary California law that the fact that one owns all the capital stock of a corporation and controls, dominates and manages it is not enough to hold that the two entities are one and the same, *Norins Realty Co. v. Consolidated A. & T. G. Co.*, 80 C. A. 2d 879, 883, 182 P.2d 593 (1947); *Dos Pueblos Ranch & Improvement Co. v. Ellis*, 8 C.2d 617, 621, 67 P.2d 340 (1933). The latter case followed with approval *Erkenbrecher v. Grant*, 187 Cal. 7, 200 Pac. 641 where it was said (p. 11):

> "were it otherwise, few private corporations could preserve their distinct identity, which would mean the complete destruction of the primary object of their organization."

This passage notes a truth that Mr. Justice Holmes repeatedly emphasized, that the very object and purpose of the corporate form is to serve as an instrumentality or medium by which a business enterprise may contract as a party separate from its stock-

holders. In *Donnell v. Herring-Hall-Marvin Safe Co.*, 208 U.S. 267, he said (p. 273):

> "Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception. But to generalize is to omit, and in this instance to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and law. A leading purpose of such statutes and of those who act under them is to interpose a non-conductor, through which in matters of contract it is impossible to see the men behind."[24]

See also *Gardner v. Rutherford*, 57 C.A.2d 874, 136 P.2d 48 (1943), particularly at 881.

Furthermore, disregard of corporate entity is a question of fact, and the findings of the trial court on that subject are not lightly to be ignored. *Associated Vendors, Inc. v. Oakland Meat Co.*, 210 A.C.A. 896 (Dec. 17, 1962). Among the findings of the District Court here are the following (R. 161):

> "18. There was no fraud or misrepresentation at any time on the part of Rheem Manufacturing or Rheem Semiconductor and no mistake on the part of anyone.
>
> "19. There is no room and no basis in the facts to disregard the corporate entity of Rheem Semiconductor or to treat it as an alter ego of Rheem Manufacturing. On and before the Basic Contract was entered into Raytheon was informed and knew that Rheem Manufacturing owned practically all of Rheem Semiconductor's stock but nevertheless contracted with Rheem Semiconductor as a distinct and separate corporate entity.

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24. He reasserted the same idea in the court's opinion in *Klein v. Board of Supervisors*, 282 U.S. 19 at p. 24, thus:

> "But it leads nowhere to call a corporation a fiction. If it is a fiction it is a fiction created by law with the intent that it should be acted on as if true."

"20. Refusing to disregard the separate corporate entity of Rheem Semiconductor will not promote a fraud or work an injustice."

5. SIGNIFICANT EXPRESS PROVISIONS OF THE LEASE AND BASIC CONTRACT PRECLUDE RAYTHEON'S INTERPRETATION OF SECTION 12 AND SUSTAIN THE DISTRICT COURT.

(a) Section 9(a) of the lease (R. 55) specifies that if any of the leased property not theretofore purchased by the lessee should in certain cases be destroyed, damaged, stolen, missing or unaccounted for:

> "In such event the portion of any such payment to Lessor determined by multiplying such payment by a fraction, the numerator of which is $250,000 and the denominator of which is the depreciated book value of all property as of June 30, 1961 on Schedule 1 to this Lease as not theretofore purchased by Lessee or sold *or for which Lessor has not accepted an offer from third persons*, shall be treated as the payment of purchase price by Lessee under this Lease."

We emphasize the reference to "an offer from *third persons*". *The only parties to this lease were Raytheon and Semiconductor.* The face of the lease so shows, and it calls Semiconductor the Lessor and Raytheon the Lessee (R. 53). Manufacturing was *not* a party to the lease. The words "third person" in an instrument necessarily include *anyone whatsoever* who is not a party to the instrument itself,—here anyone who was neither Raytheon nor Semiconductor. Since Section 9 of the Lease recognizes the right of any "third person" to make an offer, it recognized the right of Manufacturing to do so.

(b) Section 12 prescribed several options. The first was the right of first refusal granted to Raytheon. This extended only until March 1st (R. 57). After March 1st and until May 15th Raytheon had an option to purchase any leased item "not previously sold or for which Lessor has not accepted a previous offer" (R. 57), and Semiconductor had the right to sell any of

the leased items (subject to the remaining term of the lease) "to *any* party or parties at any time or times and at such price or prices as it shall deem advisable." In other words, between March 1st and May 15th Raytheon could elect to buy any item of property on the B list if Semiconductor had not already sold it to, or accepted an offer for it, from "any party". Thus, if Manufacturing in that interval had made an offer on any item on the B list before exercise by Raytheon of the right to buy, patently Raytheon could not ask that Manufacturing's offer be ignored. Raytheon's trial counsel, referring to the provisions just discussed, admitted this.[25] It being conceded that the word "offer" in Section 12 relative to the *post*-March 1st option cannot be interpreted to preclude an offer by Manufacturing, it follows that the same word in the earlier portion of the same section relative to the *pre*-March 1st option cannot be given a more restrictive interpretation. In short, a prior offer by Manufacturing after March 1st *would wholly cut off any right of Raytheon* to buy, and a prior offer by it before March 1st *would require Raytheon to meet that offer* or be foreclosed.

(c) Article I, Sec. 2(b) of the basic contract (R. 12) is the substitution clause referred to at page 7, supra. It provides:

> "At any time prior to December 15, 1961 Raytheon may elect to * * * substitute [for any item on the A list] any item or group of items [on the B list] not previously sold by Rheem [Semiconductor] to, or for which it has not accepted an offer from, *any* party * * *."

The word "any" is all-inclusive. Under this clause if Semiconductor had sold an item to Manufacturing, or accepted an offer from

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25. He said (R. Tr. 266): "after the first of March, they were free to practically do anything they wanted with the goods", and, again (R. Tr. 562-3) "the contract says that 90 days after execution of the lease, which would bring us to March 1st, Rheem [Semiconductor] is free to sell these assets to *any* party at any price and at that time Raytheon's right of refusal would have been extinguished."

it, Raytheon could not thereafter have sought to acquire that item from Semiconductor by the substitution procedure, on the theory that the purchase or offer by Manufacturing was to be disregarded. A different interpretation of the lease that would exclude the parent from making an offer effective under the first refusal clause is inconceivable.

6. OTHER PROVISIONS OF THE CONTRACT AND LEASE SHOW THAT WHENEVER THE PARTIES INTENDED A CONSEQUENCE WITH RESPECT TO A PARENT OR SUBSIDIARY OTHER THAN WOULD FOLLOW FROM THE FACT OF SEPARATE CORPORATE ENTITY, THEY EXPRESSLY SO PROVIDED AND DID NOT LEAVE THE MATTER TO ARGUMENT.

Many express provisions of the basic contract and lease demonstrate that whenever the parties intended to make some provision concerning a parent or affiliate, or whenever it was desired that a provision should not operate relative to a parent or a subsidiary as it would to any other third party, the contract expressly and specifically said so. Consequently, when in defining Raytheon's right of first refusal the parties failed to specify that an offer from the parent was not to be considered, no such exclusionary provision may be inferred. For example:

(a) In Art. I, Sec. 4 (R. 13), Semiconductor agreed to license Raytheon to use certain know-how and Raytheon agreed that it would not "assign such license to, or license or sublicense, any person, firm or corporation (except a foreign or domestic subsidiary or affiliate of Raytheon) to the use of the know-how."

Mr. Oldfield, Raytheon's chief negotiator, admitted that he was "responsible for the inclusion of provisions to permit us to license any affiliate or subsidiaries" (R. Tr. 89, 90, 91, 92) "because we wished to have the capability of licensing or sub-licensing our foreign or domestic subsidiaries" (R. Tr. 92). He requested Raytheon's lawyer to make sure that the contract contained language that *insured* this right, and his counsel drafted the particular language (R. Tr. 92, 93). Thus Raytheon did not suppose that the corporate separateness of parent and subsidiary was to

be disregarded and therefore was careful to obtain an express provision. In the same way, if Manufacturing were to be precluded from making an offer under Section 12 of the lease, it would have been expressly stated.

(b) Section 8 of the lease (R. 55) provides that the lease shall not be assigned by the lessee (Raytheon) without the written consent of the lessor, but that

> "Nothing herein shall prevent the assignment of Lessee's interest hereunder to a wholly owned subsidiary of Lessee * * *"

This, too, is plain evidence that where the corporate distinctiveness of parent and wholly owned subsidiary was to be disregarded for some specific purpose, express provision was made.

(c) In Art. I, Sec. 4(e) of the basic contract (R. 17) Raytheon covenanted that during a certain period of time it would not in any manner "adversely discriminate in its accounting practices either against its semiconductor operations and in favor of any other operation carried on by *it* or *its subsidiaries and affiliates* * * *."

(d) In Section 4(f) (R. 17, 18) it was provided that if Raytheon should transfer or assign all or a substantial part of the assets used by it in its semiconductor division "to *any* other * * * corporation whether through sale, merger, consolidation or otherwise, such transfer, sale or assignment shall be on the condition that the purchaser or successor shall assume Raytheon's obligations * * *." No reference to consolidation or merger would have been necessary if affiliates were bound without saying so.

(e) Article IV, Sec. 4 (R. 30, 31) provided that, if facts existed at the time of closing which established any material falsity, inaccuracy or breach in or of any of the representations, warranties or covenants of Semiconductor, Raytheon should be limited to the right to (1) waive the defect and require consummation, or (2) abandon the agreement without liability of any party. Subdivision (b) (R. 31) then stated that since the purpose

of the provision was to avoid penalizing the defaulting party, it would not apply if the defaulting party had actual knowledge of the falsity or inaccuracy. If the provision had ended there, knowledge of Dr. Baldwin of Semiconductor, who was going over to Raytheon, of any falsity would have charged Semiconductor. But the contract then provided (R. 31):

> "As used hereinabove, 'actual knowledge' shall mean as to Rheem [Semiconductor] only matters actually known to officers and employees of Rheem Manufacturing Company."

Without this express provision, Manufacturing's lack of knowledge of a falsity would have furnished no protection, for it was a third party, unless corporate entity was to be ignored. Since it was not to be ignored, an express provision was necessary. Thus again, when the parties intended to refer to the parent company and to make provision about it, they said so explicitly.

(f) Subjoined to the basic contract between Semiconductor and Raytheon is a statement signed by Manufacturing specifically denominated "Rheem Manufacturing Company" (R. 45) whereby it "hereby approves" the foregoing agreement. This approval was given because California Corporations Code Sec. 3901 requires the consent of a corporation's stockholders to any transaction whereby all or substantially all of a corporation's assets are being sold. If the parties intended corporate entity to be disregarded, the approval would have been unnecessary, for Semiconductor's contract would have been Manufacturing's without more.[26]

C. Manufacturing's Offer Cannot Be Ignored by Recourse to the Words "Bona Fide".

Raytheon's brief seeks (1) to read into the words "bona fide" a prescription about motive and then (2) to discredit Manufacturing's motive. Both branches of this effort are unmeritorious.

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26. Still other provisions of the basic contract recognized the separateness of Manufacturing and Semiconductor, e.g., Art. I, Sec. 4(d) (R. 16, 17), Art. III (R. 28), Art. IV, Sec. 5 (R. 32).

1. THE WORDS "BONA FIDE" BY THEMSELVES DO NOT WORK ANY LIMITATION ON THE POWER TO EXERCISE A RIGHT BY REFERENCE TO THE MOTIVE INDUCING THE EXERCISE BUT, APPLIED TO AN OFFER, SIGNIFY ONLY ACTUALITY OF THE OFFER.

"The words 'bona fide' mean 'in good faith' ", *Silver v. Bank of America,* 4 C.A. 2d 639, 644, 118 P.2d 891 (1941). " 'Bona fides' is defined as 'in or with good faith; without fraud or deceit; genuine' ", *Covert v. State Board of Equalization,* 29 C.2d 125, 134, 173 P.2d 545 (1946). The basic meaning of "good faith" is "really, actually, without pretense", *Baumgartner v. Orton,* 63 C.A. 2d Supp. 841, 844 and cases cited.

"Bona fide" is an adjective. Raytheon's brief clips phrases from cases about "motive" in connection with that adjective or its English equivalent, "good faith". But the cases involved statutes specifying a certain motive or purpose as a necessary condition to the valid exercise of a power and stating that the motive or purpose assigned must be "bona fide" or in good faith. The impact of a word or phrase used as an adjective or adverb in a given context depends on the noun or verb to which it relates. If it relates to "purpose" or "motive", the assigned purpose or motive must not be a sham; it must be the true one or, interpreting the statute in the light of the purposes of the statute, it must be the dominant one and not subordinate to another purpose which the statute denounces. Here, where the words relate to "offer", they signify only that the offer be a real offer, not a sham.

The phrase "bona fide" may not be used as a device to siphon into the contract limitations, restrictions, conditions or qualifications which a party *ex post facto* wishes that he had put into the contract when it was made. They are not a vehicle by which to rewrite a contract to accord with someone's notions of a more equitable deal. They mean "actual" or "real", and Manufacturing's offer was real (p. 31, supra). Nothing more can be read into these words than their plain meaning of actuality. In the case of *In Re Herman,* 183 Cal. 153, 191 P.2d 934, a proceeding under the California Political Code to ascertain and establish the stand-

ing of a newspaper as one of general circulation, a governing element was the Code requirement that the newspaper must have a bona fide subscription list. The court held (p. 164) that the term "bona fide" merely meant "a real, actual, genuine subscription list" of those actually paying for their subscriptions, and that it did not require that the subscription list be of any particular size or large enough to constitute the paper an adequate medium for public advertising. As it said (p. 164):

> "the legislature has not specified the number of subscribers required, and we must assume that it meant that the words *'bona fide'* were to be taken 'according to their common acceptation.' "

In *Covert v. State Board of Equalization,* 29 C.2d 125, 173 P.2d 545 (1946) the State Board of Equalization had revoked an on-sale liquor license on the ground that a restaurant could not be deemed "bona fide" because the income from the sale of liquor exceeded that from the sale of food. The court rejected the contention, pointing out that the Constitution provided no such quantitative test but rather

> "it simply requires that there be a bona fide eating place. 'Bona fide' is defined as 'in or with good faith; without fraud or deceit; genuine.' " (p. 134)

In *Silverman v. Rada Realty,* 45 So. 2d 758 (Fla. 1950), Unique Hotel Corporation leased its sole asset to Silverman with "an option of renewal for a stated term, the option, however, to be of no avail 'in case of a bona fide sale of the premises by the Lessor * * *' ". The stockholders of the lessor corporation then sold all their stock to other persons, who then exchanged it for a deed to the leased property, then organized Rada Realty Company, and conveyed to it the property in return for stock in the new corporation. Thus the lessor's new stockholders in effect transferred the property to themselves by having it transferred from one corporation they owned to another they owned. The

question was whether this was a bona fide sale of the premises so as to defeat the option of renewal. The court held that it was.

One of Raytheon's citations illustrates what should have been done if the parties had intended to limit an offer by Manufacturing by its purposes. In *Muzzy and Wells v. Allen*, 25 N.J. Law 471 (1856) a lease provided that on a sale by the lessor "for building lots" the lease should terminate. The "right to sell and thus put an end to Allen's lease" was by express words thus limited to sale for no "other purpose than for building lots" (p. 474). The parties did not use and did not look to the words "bona fide" or "good faith" to qualify a right by purpose. They expressly specified purpose.[27]

Raytheon's citations.

The bulk of Raytheon's citations[28] involve a construction of the legislative intention of federal rent control acts which forbade a landlord from suing to oust a rent paying tenant from housing on which a rent ceiling had been placed "unless * * * the landlord seeks in good faith to recover possession of such housing accommodations for his immediate and personal use and occupancy as housing accommodations." Since the statutory test of

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27. In *Ogle v. Hubbell,* 1 Cal. App. 357, 82 Pac. 217, also cited by Raytheon, the term "bona fide" also did not appear in the document. There a lease provided that on sale by the lessor the lease should terminate, conditioned by a right of preference to the lessee to purchase. The lessor purported to sell the property to her own son and another, but the finder of fact found that there was not *in truth* any sale at all, that it was wholly "fictitious" or "pretended" (p. 365). In that case as well as the *Muzzy* case the question was whether what was done was *truly* what it purported to be.

28. *Janise v. Bryan,* 89 C.A. 2d Supp. 933, 201 P.2d 466 (Appellate Dept. Los Angeles Superior Court), *Staves v. Johnson,* 44 Atl. 2d 870, 871 (D.C. Municipal Appeals); *Dargel v. Barr,* 204 F.2d 697, 699 (Em. App.); *McSweeney v. Wilson,* 48 Atl. 2d 469, 471 (D.C. Municipal Appeals); *Snyder v. Reshenk,* 131 Conn. 252, 38 Atl. 2d 803; *Gibson v. Corbett,* 87 C.A. 2d Supp. 926, 200 P.2d 216 (Appellate Dept. San Francisco Superior Court).

right to oust the tenant was the landlord's purpose, it was necessary to ascertain whether the owner's dominant and controlling purpose was to obtain possession for himself or really to eject the tenant.

Two of Raytheon's citations involve the legislative meaning of the provision of the National Labor Relations Act that it is an unfair labor practice to refuse to engage in collective bargaining in good faith.[29] Since the essence of the meaning of the term "good faith" is that whatever is referred to must be *truly* what it purports to be, and since by "bargaining" the statute means bargaining with the purpose of arriving at an agreement, to bargain in good faith means to bargain with an unpretending, sincere intention and effort to arrive at an agreement. The correlative is that a "bona fide" *offer* is one made with true intent to consummate the offer, no more.[30]

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29. *National Labor Relations Board v. James Thompson & Co.,* 208 F.2d 743 (2 Cir. 1953) and *National Labor Relations Board v. Stanislaus Imp. & H. Co.,* 226 F.2d 377 (9 Cir. 1955).

30. Others of Raytheon's citations involve the interpretation of the words "bona fide" or "good faith" in statutes or contract so remote from the present situation that we treat them in this footnote.

Kam Koon Wan v. E. E. Black, Ltd. 75 F. Supp. 553, 561, (D. Haw. 1948) involved the right to back wages under federal statutes which provided that it should be a defense that the employer acted "in good faith in conformity with and in reliance on any administrative regulation, order, ruling, approval or interpretation of any agency of the United States." The wages had not been paid because of actual reliance on a wage freeze imposed by the military government of Hawaii during World War II.

In re Vater, 14 F. Supp. 631 (E.D. Ky. 1946), involved a provision of the bankruptcy law that a petition for composition and extension could be amended to one for bankruptcy if there had been a proposal in good faith to the creditors for composition and extension. A proposal, as the court described it, "to pay the indebtedness if and when they [the debtors] are financially able" (p. 633) was a "preposterous" proposition that no creditor could be expected to give any serious consideration to and therefore was not really a proposal at all (p. 633).

McDonald v. Thompson, 305 U.S. 263, was a suit by a trucker to enjoin the State of Texas from preventing him from using the highways on the ground of conflict with the Federal Motor Carrier Act of 1935. Since the trucker had no certificate from the Interstate Commerce Commission, no conflict existed unless he had been in "bona fide operation as a

2. MANUFACTURING'S PURPOSE AND MOTIVE, IF RELEVANT, WERE LEGITIMATE.

(a) Raytheon's argument is based on an assumption as to interpretation of the contract and the purpose of the contract which is foreclosed by the findings.

But even if some notion of "legitimacy" of purpose were here to be read into the words "bona fide", Raytheon's argument would fail. "Legitimacy" is to be tested by some standard, and *the only standard here is the intent of the contract,* for Raytheon has no rights save those that the contract gave it.

The case thus comes back to interpretation of the contract. Just as the meaning of "good faith" in a statute is a matter of interpretation of the statute, the meaning of "good faith" in a contract is a matter of interpretation of that contract. *And on the basis of all the evidence the District Court held that the parties did not intend to preclude an offer by Manufacturing.*

From first to last Raytheon never wished to commit itself to anything while endeavoring to commit Semiconductor (see pp. 5-8, 11, supra). In defense of its passion for non-commitment, it has said, in effect, "Such was our bargain". The question, then, is: What was the bargain?

The distillate of all Raytheon's argumentation is that Manufacturing had no right so to act as to require Raytheon to pay $531,584 for the assets, if it wanted them, when the contract gave it an option to buy for less. Indeed, Raytheon says so

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common carrier by motor vehicle on June 1, 1935." He had been in operation on that date only because he had obtained a temporary injunction against the Texas authorities, which was dissolved on appeal.

Woolley v. Standard Oil Co. of Texas, 230 F.2d 97 (5 Cir. 1957) involved an oil lease requiring rental installments to be paid to a specified depository for distribution to the usual multiplicity of lessors and assignees of lessor interests. To avoid the harsh rule of Texas law that a lease terminates on failure to pay rental promptly, the lease provided that it would not terminate if the lessee "shall, in good faith and with reasonable diligence attempt to pay any rental, but shall fail to pay or incorrectly pay some portion thereof" and remedied the error on notice. The lessee promptly paid the correct amount of an installment of $125.00 to the specified depository, but an allocation schedule was in error due to a bookkeeper's mistake resulting from assignments.

boldly, when it asserts (Br. 26, 27) that the "essence of the agreement was [after segregating List A] to give Raytheon the right to select any or all of the remainder and buy it at fair market value", and that the offer and acceptance "were a bald attempt to subvert that contract right"; and again (Br. 35), when it speaks of the "natural scheme provided for in the agreement", or refers (Br. 39) to the offer as "a device to take away Raytheon's agreed right of selection and force a higher price". This, of course, is a question-begging and circular argument, because it assumes that the contract gave Raytheon an unlimited right of selection and right to buy for less. Unless the contract is read as precluding Manufacturing from making an offer at all, this is a false assumption. As we saw at pp. 7, 8, supra, Semiconductor reserved the right to receive an offer from others than Raytheon *as a limitation on Raytheon's free option, a limitation on an otherwise wholly one-sided contract that would have left Semiconductor denuded to Raytheon's cannibalism.*

(b) Raytheon's argument comes back to an interpretation of the contract that would disregard the corporate entity, and this is foreclosed by the findings.

In the very breath of denial that its case rests on disregard of the corporate entity, Raytheon stultifies its denial by asserting that bona fides does not "hinge [ ] upon the readiness and ability of the offeror to complete the purchase when to do so would mean merely putting money from one pocket into another" (Br. 22), and this is embroidered with reiterated assertions that the amount Manufacturing paid Semiconductor would make no "economic difference" (Br. 32-35, 39, 40). *But unless corporate entity is disregarded, it is false to speak of putting money from one pocket into another.*

Raytheon states that it essentially predicates its claim that the offer was not bona fide on two supposed facts (Br. 23-26). It says, first, that Manufacturing did not want the equipment for itself. Even if true (the facts are stated at pp. 8, 9, 13, supra), this

would be irrelevant, because nothing in Section 12 of the lease specified that an offer had to be by one who wished to acquire the assets for his own use.[31] Plainly an offer by a third party—Company X—could not be held to be mala fide on such a ground. Without disregarding corporate entity, a different rule cannot be applied to the offer by Manufacturing. Realizing this, Raytheon adds, as a second ground, that Manufacturing's offered price was above the fair market value of the equipment to any third party purchaser to whom Manufacturing might resell it. Were this true, it would be irrelevant, unless, again, corporate entity were to be disregarded. Once it be granted that Manufacturing was free to make an offer at all, not a syllable can be found in the contract limiting its freedom as to the amount of its offer. The fallacy of Raytheon's argument is exposed by positing, again, that a complete stranger—Company X—had made an offer to Semiconductor. Raytheon could not object to the amount of the offer.

(c) Raytheon's various other attempts to belittle Manufacturing's "good faith" are precluded by the findings.

Even if one departs from the contract into a realm of visceral reactions to "good faith", Raytheon's arguments fail.

Its statements about the offer being above market value and allied matters (Br. 23, et seq.) are erroneous, in part an effort to draw inferences from the record contrary to those drawn by

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31. The District Court had a realistic understanding of the situation, as shown by the following colloquy (R. Tr. 205: 7-16):

"MR. LASKY: They were going out of the business of manufacturing semiconductor devices and selling semiconductor devices without in any way [having] made up their minds they would be out of it permanently. Yes, that is the fact.

"THE COURT: And that, of course, would not foreclose them from the acquisition of any and all items of the B contract or the B exhibit if at a later stage they saw fit either to resell the items or to use them themselves.

"MR. WHEAT: I think Mr. Lasky's comments cover the point to my satisfaction, your Honor."

the trial court, and, in part, particularly as respects the Ellison appraisal, a plain distortion of the record.

The District Court found that the amount of the offer was based on the appraisal of fair market value by a thoroughly competent and qualified appraiser, and that the offer was "legitimate" and "fair" in all the circumstances (see pp. 16, 17, 25, supra). Raytheon summoned Mr. Ellison as its witness at the trial and justified doing so as follows (R. Tr. 276):

> "MR. WHEAT: On the other hand, I think that since their good faith is largely dependent upon their actions taken upon reliance upon Mr. Ellison's appraisal, it is only fair for us and the Court to know the underlying circumstances that motivated Mr. Ellison".

Raytheon thus took the position that if Mr. Ellison conscientiously tried to appraise the fair market value of the property and if Manufacturing conscientiously used his figure as its offering price, its offer was "bona fide". *The District Court then found these to be the facts.* Raytheon having tendered the issue of good faith or "bona fides" to the District Court as a question of fact and as "largely dependent" on the factual elements just mentioned, that court's findings are an end of the matter. As said in *Shumate v. Johnston Publishing Co.*, 139 C.A. 2d 121 at 130, 293 P.2d 531 (1956) "a party cannot request that an issue be submitted to a jury as a question of fact and on review escape the consequences." Good faith, when it is an issue, *is an ultimate fact* and a question for the determination of the trier of the facts; an appellate court will not weigh the evidence or substitute its inferences for those of the trier. *Fuller v. Berkeley School District*, 2 C.2d 152, 161, 40 P.2d 831. And see Raytheon's own citations, *Janise v. Bryan*, 89 C.A. 2d Supp. 933, 940, 201 P.2d 466, citing cases; *Staves v. Johnson*, 44 Atl. 2d 870, 871; *Dargel v. Barr*, 204 F.2d 697, 700; and *National Labor Relations Board v. James Thompson & Co.*, 208 F.2d 743 (2 Cir. 1953), where, on this

very ground, the court (Learned Hand, J.) refused to enforce a Labor Board order because the Board had ignored an examiner's finding that a refusal to bargain was in good faith.

Raytheon's brief (p. 31) sneers at Mr. Ellison as the "four hour appraiser" and belittles his appraisal as hurried. But it is a sufficient reply to quote the Trial Court (R. Tr. 628):

> "I find affirmatively that the bid entered by the parent corporation was a legitimate bid predicated upon an appraiser's valuation which has not been disputed, and certainly not impugned, nor does Mr. Ellison's integrity bear any marks of erosion. He was here for cross-examination. He impressed this Court as a very, very fine, well-versed man in his field, and I am satisfied from his testimony that the predicate for his findings, although they were very quickly made, would be fortified in the light of any contra experts that we might hear from. He did say that the bid of $539,000-odd of the Rheem bid was a fair bid under all the circumstances."

This is also a sufficient reply to the efforts to belittle the fact of reliance by Manufacturing and Semiconductor on the Ellison appraisal.

Raytheon asserts that no negotiations between Manufacturing and Semiconductor preceded the offer and acceptance, that Semiconductor held no directors' meetings to discuss the offer and made no effort to obtain a higher price, and that Manufacturing alerted Mr. Grant to sign the acceptance (Br. 28-30). The facts are these: Whether an offer should be made by Manufacturing to Semiconductor had been a matter of general discussions among the executives of the two companies (Mallatratt, R. Tr. 208). Mr. Grant was both a director (R. Tr. 443) and vice president of Semiconductor (R. Tr. 444). Its board had conferred authority on him with respect to the disposition of its assets (R. Tr. 448). He was told that Manufacturing intended to make an offer to Semiconductor (R. Tr. 448), knew what Mr. Ellison's appraisal of fair market value was (R. Tr. 448), and when

the offer was presented to him he compared it with Ellison's appraisal and had in mind that they were identical when he accepted the offer (R. Tr. 450). Not even good business judgment required that he then shop for a higher price. Much less can it be said that failure to do so showed bad faith.[32]

Similarly (Br. 30) Raytheon belittles the Japanese and other negotiations for disposition of the assets, but *credibility was for the Trial Court to decide.* Raytheon would discredit the evidence because the "outside 'negotiations' were not carried further" after Manufacturing's offer was accepted (Br. 30). But just 6 days after the sale to Manufacturing was consummated, this suit was brought, a restraining order obtained, and this suit was then pressed to an early trial. With litigation over its rights to the assets, Manufacturing was unable to carry on further negotiations to dispose of the assets.

As an allied argument (Br. 31, 32) Raytheon belittles the reality of the desire to protect the value of "full lines of equipment" by citing the testimony of its employee, Breene, that no full production line for producing any given model of semiconductor device could be built up from the B list. Breene disavowed testifying that no full line of equipment could be built up to manufacture any kind of electronic equipment (R. Tr. 320, 321). But, more important, the inquiry was one of Manufacturing's state of mind. Raytheon goes so far as to say (Br. 32) that "Defendant's counsel expressed no doubt that Mr. Breene was fully qualified as to whether a full line of equipment could be gotten out of

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32. Raytheon also would create some innuendo by the statement (Br. 28) that "Grant, like the other officers of Semiconductor, received his compensation from Rheem [Manufacturing Company]". Not only does the cited testimony relate to the date of testifying in May 1962, but it is pointless: Manufacturing had a legal staff, a controller's department, a tax department and other staffs, and as a method by which costs could be kept at a minimum the practice was followed of making the services of those specialized staffs available to the several subsidiaries in consideration of payment by each subsidiary of certain annual charges based on investment (R. Tr. 359-361). Grant was paid by Manufacturing as its assistant controller (R. Tr. 403, 404).

the deal or not." But Raytheon fails to note the context of that statement, which was this (R. Tr. 314, 315):

> "MR. LASKY. Just a moment. If the Court please, it looks to me as if this line of inquiry is irrelevant and I object on that ground. The issue to which I suppose everything is directed is one of Rheem Manufacturing's good faith, and belief of this gentleman, whom I have no doubt is wholly qualified as to whether you could get a full line of equipment out of the B list or not, would have no bearing upon the state of mind of Rheem Manufacturing Company, and Mr. Mallatratt, who was concerned with whether there was a full line of equipment there. If he thought there was and that it would be cannibalized, this gentleman's belief that there was not would not bear upon the good faith element."

On these very matters the Trial Court said at the close of the trial (R. Tr. 611, 612):

> "*There were plain, manifest discussions which had not been denied in this record concerning the probability, if not the prospect, of the parent company entering a bid. There were at the time references made to the possibility of a Japanese enterprise, joint venture, if you please. Whether or not the full line could complement one or the other is, of course, open to conjecture.* I am not sitting here as a scientist; I am sitting here as a Judge. The scientist said on the stand the other day that maybe the line couldn't be completed. Now, that may be true. I am not disagreeing with the scientist, * * * I am bound under my duty and my oath to interpret the contract, * * *"

Other arguments of Raytheon trifle. For example, it argues (Br. 29) that Manufacturing did not try to buy from Semiconductor at a lower price. Then, on the same page, it castigates Manufacturing and Semiconductor for rescinding the first offer so as to reduce the amount in the second offer. Thus Raytheon wants it both ways, that it was bad faith to reduce the offer and bad faith not to reduce it more! Since Manufacturing owns 99.9%

of Semiconductor's stock, it had a fiduciary relationship to Semiconductor not to offer too little or to hold it to a contract it could not perform because it inadvertently covered undeliverable items (See p. 19, supra). Adhering exactly to the impartial appraiser's valuation as first made and then revised on elimination of non-available items, and not trying either to push it up or chisel it down, shows good faith, not bad faith, if relevant to the issue at all.

Even more trifling is the argument (pp. 33, 34, 39, 40) that "Semiconductor gave its parent * * * a gratuitous indemnity against loss if it could be legally established that Raytheon had exercised its right to purchase", citing P. Ex. 14. This refers to the fact that in its request of Manufacturing for payment of the balance of the purchase price (P. Ex. 14), Semiconductor wrote:

> "In the event, however, it is established by Raytheon Company in any appropriate legal proceeding that it has effectively exercised its right to purchase such property, we will reimburse you for any loss you might sustain by reason thereof".

Raytheon's letter of January 23, 1962 (Ex. 4 to the complaint) had already ended with the threat of litigation in the event of any sale to Manufacturing. Should such litigation result in a judgment that Raytheon had effectively exercised its right to purchase the property, it would follow that Semiconductor had no property to deliver to Manufacturing on June 1st in return for the $531,584 it was receiving. There would be a failure of consideration, and Semiconductor would be legally obliged to return the purchase price. Under elementary law and the old ditty that

> "He who sells what isn't his'n
> Must pay the price or go to prison",

the passage in Semiconductor's letter stated no more than an elementary legal obligation.

(d) If there is bad faith in this case, it is Raytheon's.

If there is bad faith in this case, it is Raytheon's. Raytheon's complaint (R. 1) proclaimed that the equipment was worth to it every cent of the $531,584 (see pp. 22, 23, supra). Yet, as revealed in its discussion of the issue covered in Part II below, its purpose in seeking to have Manufacturing's offer declared null was to snap up the equipment at a junk price in the teeth of the rejection of that very offer the previous October.

The contract was a highly favorable one to Raytheon, particularly in view of the literal application of the substitution clause which the District Court quite naturally appraised as giving Raytheon a very one-sided advantage (see pp. 7, 8, supra). Had there been, in addition, a preclusion of Manufacturing from making an offer under Section 12 of the lease, the contract would have been inequitable and intolerable beyond belief.

Semiconductor would never have agreed to such a preclusion, no such preclusion was provided, and none can be supplied by interpretation, by doctrines of disregard of corporate entity, or by perversion of the words "bona fide".

II.

SINCE RAYTHEON WAS NOT ENTITLED TO HAVE THE ASSETS APPRAISED WITHOUT REGARD TO THEIR USE AND UTILITY IN RAYTHEON'S PLANT AND AS IF DISMEMBERED AND BROKEN UP, THE APPEAL FROM PARAGRAPH 3 OF THE JUDGMENT FAILS.

Paragraph 3 of the judgment relates to the determination of the purchase price of such of the List B items as were not involved in Manufacturing's offer and for which Raytheon must pay a price as appraised by American Appraisal Co.

A. The Question.

While Raytheon formally appeals from the following provision of paragraph 3 of the Judgment (R. 167):

> "In making such appraisal the value to be appraised is the fair market value of the assets to plaintiff Raytheon Company in the present location of said assets at the Mountain View plant of plaintiff Raytheon Company as part of the operations of Raytheon Company",

the precise question is whether the District Judge erred in holding (R. Tr. 628) that

> "fair market value certainly contemplates under the authorities that recognition be given to the use to which the article is placed, and I can't conceive that these assets, valuable as they are or invaluable, should be regarded as something to be dumped on the loading dock and therein appraised when we find that Raytheon has a valid and substantial use thereof."

Raytheon states the question (Br. 42) as

> "whether 'fair market value' means the value of the selected items dismounted and ready for bids by any and all prospective purchasers, or whether it means the value of the items to Raytheon in place, installed and in operation."

This statement of alternatives disingenuously describes Raytheon's position (see p. 59 below) and incorrectly states defendants' and the Trial Court's. According to Raytheon (Br. 46) "The value to Raytheon of the 'B' list items is a false criterion." But the alternative to this position is not "the value of the items to Raytheon in place, installed, and in operation"—that would be a figure for the whole "B" list of the magnitude of $1,750,000, as Ellison testified (see p. 16, supra). The alternative is a value determined by giving consideration, as one of the elements, to the value to Raytheon at the present location in the Raytheon plant as part of Raytheon's operations. This is what the Trial Court held. Its statement in its oral opinion, quoted above, was its ruling.

The formal expression in the judgment of the ruling was drafted and submitted by Raytheon. After announcing its decision

in the foregoing words, the court ordered that "plaintiff [Raytheon] shall prepare findings of fact and conclusions of law consistent with this and prior orders" (R. 140). Raytheon then submitted as part of its proposed conclusion of law No. 3 (R. 142-148) this:

> "In making such appraisal the value to be appraised is the fair market value of the assets to Raytheon in their present location as part of Raytheon's operations" (R. 148).

Defendants accepted Raytheon's proposed Conclusion No. 3 without objection or suggestion for change (R. 163-164), and the court adopted Raytheon's very language for its conclusion (R. 164).

Raytheon may not, therefore, assign error to this expression of the court's ruling. The doctrine of "invited error" precludes it.[33] Consequently, the only question now available for Raytheon is whether the District Court erred in holding that, in determining

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33. It is elementary that "a party cannot successfully take advantage of asserted error committed by the court at his request", *Shumate v. Johnston Publishing Co.,* 139 C.A. 2d 121, 130, 293 P.2d 531 (1956).

"If it were error, appellants invited it", *Dietl v. Heisler,* 188 C.A. 2d 358, 369; 10 Cal. Rptr. 587 (1961).

For example, in *Tucker v. Cave Springs Min. Corp.,* 139 Cal. App. 213, 218, 33 P.2d 871 (1934), the court said:

> "As a final point appellant urges that the findings 'constitute a negative pregnant and are self destructive'. The findings of the trial court as signed and filed bear the caption, *'Proposed Substituted* Findings of Fact and Conclusions of Law.' Noting this in the clerk's transcript as transmitted to this court, the original file of the trial court was ordered produced for our inspection. It is apparent that the trial judge adopted as correct and signed the findings as *prepared and proposed by defendant,* which, as appellant, is now urging a reversal of the judgment because they are defective. The material issues raised by the pleadings are sufficiently covered by the court's findings, and appellant cannot complain at this time of defects for which it was responsible." [Italics are the court's]

Similarly, in *John B. Stetson Co. v. Stephen L. Stetson Co., Ltd.,* 133 F.2d 129 (2 Cir., 1943), the court said (p. 131):

> "We do not consider the restriction contained in paragraph 5 of the decree to be a departure from the intendment of our opinion and mandate. *Moreover, counsel frankly admitted that the form of pro-*

"fair market value", one element in the determination is the value of the assets to Raytheon in their present operation and location.

B. Discussion.

Raytheon argues that the value of the assets must be determined as if Raytheon had no use for the equipment, was not interested in buying it, had rejected it, ripped it out of the plant and placed it on the shipping dock for removal, and without regard to its value to the most *probable* customer with the most immediate need and as part of an assembled plant. It predicates this on the premise that if Raytheon did not buy the assets, its obligation was to place the equipment, dismounted, on the dock (Br. 45). But, in ascertaining what price Raytheon should *fairly* pay *on electing to* buy, one does not proceed on the basis that it has elected *not* to buy. It is still one of the prospective purchasers constituting the possible market. Its own presence and need are an element of the market and a most important one. Raytheon's phrasing that "fair market value" means "value * * * dismounted and ready for bids by any and *all* prospective purchasers" is internally inconsistent because "dismounting" presupposes the elimination of an important prospective purchaser, Raytheon itself.

As on the appeal from paragraph 1 of the judgment, the issue is one of interpretation of words as used by the parties in a contract, here "fair market value". The trial court interpreted the contract as not contemplating that price to Raytheon was

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posed decree submitted on behalf of appellant invited adoption of the language to which objection is now urged."

So also in *Omaha Hardwood Lbr. Co. v. J. H. Phipps Lumber Co.*, 135 F.2d 3, 10 (8 Cir. 1943):

"A party can hardly ask appellate relief from matters in a judgment which were included in his own requested findings and conclusions, without some satisfactory showing of excusable mistake, which he has first duly presented to the trial court."

to be calculated as if it were totally uninterested in the assets. That interpretation is sustained by the evidence, which includes: (1) The fact that Semiconductor had refused to sell these assets to Raytheon at 30% of book value, and (2) the fact that Raytheon found the equipment essential to its operations.

We agree with Raytheon that "fair market value" is what a willing buyer would pay and a willing seller accept, neither being under legal compulsion to buy or sell. But it is also elementary that special value to a particular buyer or prospective buyer is an element in the fair value. "Fair market value" is determined both (1) by eliminating *any* condition of a forced sale and (2) including

> "a value based on the *highest and best use of the property.*" *Pacific States Sav. & L. Co. v. Hise,* 25 C.2d 822, 839, 155 P. 2d 809 (1945).

Semiconductor cannot be put in a position of taking what it would have to take if compelled to sell, and Raytheon cannot escape paying a value based on the highest and best use of the property.

The accepted definition appears in *Sacramento, etc. R.R. Co. v. Heilbron,* 156 C. 408, 409, 104 Pac. 979 (1909):

> "the *highest price* estimated in terms of money which the land would bring if exposed for sale in the open market, with a reasonable time allowed in which to find a purchaser, buying with knowledge *of all of the uses and purposes to which it was adapted and for which it was capable.*"

This very definition has been called the "classic definition", *Joint Highway Dist. No. 9 v. Railroad Co.,* 128 Cal. App. 743, 755, 18 P.2d 413 (1933), and is often repeated, as in *Covina Union High School Dist. v. Jobe,* 174 C.A. 2d 340, 353, 345 P.2d 78 (1959), and *People v. Ricciardi,* 23 C.2d 390, 401, 144 P.2d 799 (1943), where it is said to be the definition of "universal acceptance". The opinion in the *Sacramento* case also states that market

value is "the *highest sum* which the property is worth to persons generally, purchasing in the open market in consideration of the land's *adaptability for* any *proven use.*"[34] The opinion also states (p. 412) that facts bearing on the use to which a building is particularly adapted are relevant. See also *People v. Ocean Shore Railroad,* 32 C.2d 406, 428, 196 P.2d 570 (1948) (market value is to be determined in view of *all* the uses to which it is adapted and available).

The leading case is *Boom Co. v. Patterson,* 98 U.S. 403 (1878) which points out that what gives "market value" is *capability* of use estimated by reference to *any and all uses* for which the property is suitable (p. 408). A value to a particular person arising from the peculiar fitness of the assets for the particular purposes of that person is an important element in estimating their fair market value (p. 409). Fair market value is to be determined with reference to "the value of the property for *the most advantageous uses* to which it may be applied" (p. 410).

In *Grand River Dam v. Grant-Hydro,* 335 U.S. 359 (1948) petitioner, a public corporation, condemned property of the defendant, a public utility, for a hydro-electric project. It was held that the value of the land for use as a power site by petitioner was to be taken into consideration. The court said (pp. 372, 373):

> "In a voluntary purchase of this land by the petitioner, as a willing purchaser, from the respondent, as a willing and unobligated seller, the value of it as a power site inevitably would have entered into the negotiated price."

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34. It is significant that Raytheon, while quoting from *Sacramento, etc. R.R. Co. v. Heilbron, supra,* (at Br. 43) omits everything in the first passage quoted above but the words "would bring if exposed for sale in the open market" and omits everything from the second passage above but the words "worth to persons generally, purchasing in the open market".

In view of Raytheon's technique portrayed at pp. 7, 8, supra, the following from *United States v. General Motors Corp.*, 323 U.S. 373 (1945) is apropos (p. 382):

> "It is altogether another matter when the Government does not take his entire interest, but by the form of its proceeding *chops it into bits*, of which it takes only what it wants, however few or minute, and leaves him holding the remainder, which may then be altogether useless to him, refusing to pay more than the 'market rental value' for the use of the chips so cut off. This is neither the 'taking' nor the 'just compensation' the Fifth Amendment contemplates."

Lewis on Eminent Domain (3d ed. 1909) Sec. 707 states:

> "The market value of property includes its value for any use to which it may be put. If, by reason of its surroundings, or its natural advantages, or its artificial improvements, or its intrinsic character, it is peculiarly adapted to some particular use, all the circumstances which make up this adaptability may be shown, and the fact of such adaptation may be taken into consideration in estimating the compensation." (p. 1233)
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> * * *
>
> "* * * If it has a pecular adaptation for certain uses, this may be shown, and if such peculiar adaptation adds to its value the owner is entitled to the benefit of it." (p. 1238)

In *Southern California Edison Co., Ltd., et al. v. United States*, 117 Ct. Cl. 510 (1950) involving a claim of just compensation for the taking of two steam electric generating units, while the court said that it could not apply a market value test since such items were so infrequently bought and sold as to have no market, it said (p. 531):

> "Then, too, in arriving at just compensation, we cannot disregard the value of the two units as a part of a system any more than we could assume that the second-hand value of an elevator would be fair compensation for its removal from a building. Units 7 and 8, although used principally as re-

serve, were operating parts of a going utility. If we were to apply the market-value test, we should want to know, not merely their value as units detached from the plant, but also the market value of the whole system, or at least of the whole plant of which they were a part, before and after the taking."

Samuel M. Coombs, Jr., Trustee v. United States, 106 Ct. Cls. 462 (1946) involved a taking of essentially all the tools and equipment of a bankrupt plant manufacturing precision airplane parts. The court said:

"The Spier Aircraft Corporation had assembled tools and equipment and leased a building, all of which as a unit was especially suited and adapted to the making of certain airplane parts. This constituted a factory. The defendant, in awarding compensation, proceeded as though the articles comprising the factory did not in fact comprise a factory, but were isolated in storage, each article separate and distinct from the others. But when they were requisitioned they were not separate and distinct, but constituted a factory, especially adapted for the manufacture of airplane parts, and as so adapted, arranged, interrelated, and organized had a special value." (p. 475)

Arkansas Valley Railway Inc. v. United States, 107 Ct. Cls. 240 (1946) involved the taking of the rails, track fastenings and other metal track material of plaintiff's railroad. The court applied "as a basis fair market values" (p. 258) and rejected the government's contention (p. 256) that plaintiff is entitled only to the "detached value of the material taken".

Raytheon's citations.

Most of Raytheon's citations involve just compensation in eminent domain. Since the issue in the present case is one of interpretation of a contract, that body of law is relevant only by way of analogy, and on that basis we have cited eminent domain cases

above. But all rules in condemnation cases are not applicable, for condemnation cases can involve problems wholly peculiar to the situation of a sovereign.[35] Frequently the sovereign must have a particular property or forego a public project entirely, so that, if necessary, it might pay any amount, however exorbitant. Advantage of that necessity may not be taken. But unlike a condemnor in such a situation, Raytheon could buy in the open market, if it wished. It will be recalled (p. 16, supra) that Ellison testified to three values for the List B assets:

1. At one extreme a disruption value to Raytheon of $1,750,000.
2. At the other extreme a value of $400,000 to $500,000 in a lot sale to a speculator or liquidator.
3. In between, a value of $636,000 as a conservative fair market value.

If we were seeking $1,750,000 for the List B assets, or a proportionate amount for those portions of the Group 2 assets which Raytheon elected to buy,[36] some of the condemnation statements might be relevant. But we are not.

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35. Thus, *United States v. Miller,* 317 U.S. 369 (1943), cited by Raytheon, states that often in condemnation cases the criterion of market value is not applied; e.g.,

> "Again, strict adherence to the criterion of market value may involve inclusion of elements which, though they affect such value, must in fairness be eliminated in a condemnation case, as where the formula is attempted to be applied as between an owner who may not want to part with his land because of its special adaptability to his own use, and a taker who needs the land because of its peculiar fitness for the taker's purposes." (p. 375)

Pursuant to this view the Court rejected a settled California rule which allows market value, as inconsistent with a federal rule in condemnation cases (p. 379, bottom, page 380, top).

36. The situation as to the whole of the Group 2 assets is summed up in Finding 24, R. 163, that Ellison appraised the Group 2 assets "to be conservatively worth $91,200 disassembled, dismantled, removed from the plant acquired by Raytheon from Rheem Semiconductor and placed on the shipping dock at the plant but as *having a fair market value* in the range of the residual book values, viz., $337,126 if maintained for the continuing use for which they were installed at said plant."

On the other hand, *Baetjer v. United States*, 143 F.2d 391 (1 Cir.), cited by Raytheon,[37] points out (p. 396, 2d col.) that value due to strategic location of land is important as a factor influencing hypothetical bargainers. *One of the bargainers here is obviously Raytheon itself, and Raytheon's attempt to determine the worth of the property that it should pay as if Raytheon did not exist is the cardinal vice in its argument.*

Raytheon (Br. 46) cites *In re Alberti*, 41 F. Supp. 380 (S.D. Cal.) for a statement that "value in use to the owner is not a criterion of [market] value. Nor is value in use to the person who seeks to acquire the property." But *In re Alberti* supports us, not Raytheon. The court said (p. 381) that:

> "The law of California says specifically that while the highest use to which the property can be put is a criterion of value, no value can be determined solely by such use."

In other words, *the highest use to which the property can be put is a criterion of value.* The court in the *Alberti* case reversed a referee, not because he considered that use, but because he de-

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37. Raytheon cites this case for its application of the rule, peculiar to eminent domain, that the person from whom a piece of land is taken is not entitled to a special higher value than the land has to him alone by reason of its combination with other lands not taken. Nor may he recover "sentimental value" to himself, which is all that *Maher v. Commonwealth*, 291 Mass. 343, 197 N.E. 78 holds.

How far afield Raytheon goes—and with what accuracy—is illustrated by its citation of *Southern California Fishermen's Association v. United States*, 174 F.2d 739 (9 Cir. 1949). There the United States condemned land owned by the City of Los Angeles on which were certain improvements erected by the Fishermen's Association which claimed as recompense for the improvements their value as if attached to the land. Raytheon suavely describes this as a case where the improvements were maintained by the Association under city permits "revocable on 30 days' notice" (Br. 44). In fact the City had *already revoked* the permits before the United States sought to condemn, so that the Fishermen's Association no longer had any interest in the improvements as attached to the land, and the basis of evaluation in eminent domain cases "is not what the taker gained but rather that which the owner lost" (p. 740). This rule of eminent domain has no bearing in the present case.

termined market value on the basis of that use as the *sole* criterion and thereby reached a value *too* low, acting on opinion testimony based *solely* on "present yield" (p. 386), its income production as a farm in recent years (p. 384, 1st col.). Raytheon wishes to eliminate the element of use as any criterion whatever.

For the same reason the *Joint Highway* case, 128 Cal. App. 743, 18 P.2d 413, supports us and not Raytheon. There appellant, condemning part of a right of way of an abandoned railroad for use as a highway, appealed from an award based upon testimony which considered availability for transportation purposes. It contended that since the land was "too steep even to raise goats", it had only a nominal market value (p. 749). Affirming, the court not only repeated (p. 755) the universal definition of "fair market value" which we quote at p. 60, supra, but it said (p. 752):

> "It is apparent from what has been said that the property involved in this litigation was far better adapted for use for railroad or highway purposes than for any other purpose and that its value in use for such purposes was far greater than its value in use for any other purpose. Its use for such purpose was, therefore, what has been termed its 'highest available use'."

Raytheon's final argument (Br. 49, 50) consists of (a) a perverse distortion of Ellison's testimony in the teeth of the findings (see pp. 17, 25, supra)[38] and (b) Mr. Kather's version of the Kather-Stroup conversation of January 12th, which the trial court

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38. Raytheon asserts (Br. 49) that Mr. Ellison made a first appraisal, that Manufacturing "did not like the result" and that "instructions were hastily given to Ellison to produce another appraisal", that being "disappointed with the results of the 'fair market value' appraisal which it had ordered * * * it told Ellison to apply different standards". Not even the fact that counsel who wrote the brief was not trial counsel can excuse these statements.

rejected in favor of Mr. Stroup's version, a subject we discussed at page 14, supra.[39]

The common sense of the situation.

If Semiconductor were under no contractual compulsion to sell the assets to Raytheon, would it sell them to Raytheon at a price that gave no consideration at all to their value to Raytheon? Conversely, if Raytheon had no contractual right to compel the sale, would it fail to have its offer take cognizance of that value and run the risk that the equipment would go elsewhere? In canvassing the available market to determine possible buyers of the assets, would the existence of Raytheon itself be ignored? Since market price is the resultant of supply and demand, is an important element of demand to be eliminated from the equation? The answer to all these questions is obviously "no". Raytheon's chief executive in the premises testified that he believed at the time that it would be contrary to Raytheon's best interests to purchase the items elsewhere instead of from Semiconductor (R. Tr. 112, 113) "because [he] felt that [he] could not buy this equipment on the open market for as little as [he] could get it from Rheem Semiconductor" (R. Tr. 113).

Furthermore, the need of Raytheon in its operations where located is patently an important element that would enter into the

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39. Stroup added to his statement of willingness to defer Manufacturing's offer the condition that Raytheon was not to rush in meanwhile with a notice of election to buy assets (R. Tr. 524). Raytheon's brief (pp. 49-50) distorts this by arguing that this was an unfair proviso, that it amounted to a request of Raytheon to give up the right granted by Section 12 of the lease to buy List B assets at a value to be appraised. It was, however, no such thing. Once Manufacturing made its offer, Raytheon would have only a right of first refusal. Raytheon had not seen fit to exercise its right to buy at an appraised value up to that time, and Mr. Stroup was merely saying that now that Raytheon was being told by Manufacturing that Manufacturing intended to make an offer, it was only fair that while it was deferring doing so in order to give Raytheon a chance to make up its mind, Raytheon should not rush in with a notice that would cut off Manufacturing's offer.

calculations of a third party, e.g., a used equipment dealer, in determining what it might bid on equipment, if not already committed to Raytheon, for Raytheon itself would be a prospective customer for resale. The purpose of the option to Raytheon was not to immunize it from competition factors in determining the price at which it could buy—not to permit it to "steal" the assets—but merely to give it priority of right to purchase with an appraisal serving the function of competition.

We submit that the District Court's determination is correct and should be affirmed.

III.

ANSWER TO RAYTHEON'S DISCUSSION OF MOOT OR FALSE ISSUES.

A. Reductions from the Purchase Price.

1. As noted (p. 27), Raytheon's notice of appeal purports to appeal from "so much of paragraph 2 of the judgment as provides that the price of $531,584 became payable * * * without further providing for crediting against said price" rentals paid and to be paid. This is not an appeal from something the judgment provided but from a supposed omission, and it raises a non-existent issue. Nothing in the judgment denies Raytheon's right to so apply rentals. Our cross-appeal challenges the adjudication that Raytheon exercised the right of first refusal, and, if we are correct in that submission, the point Raytheon here makes is moot. On the other hand, if our submission on the cross-appeal is incorrect, we do not deny the right to apply rentals. We so advised Raytheon's counsel on receipt of the notice of appeal. The judgment said nothing on the subject, one way or the other, because in a suit for declaratory relief—as this was—the court passes only on the issues in controversy, and no controversy existed or was pleaded by anyone as respects the right to apply rentals *if* the right of first refusal had been exercised. Moreover,

although Raytheon proposed findings and conclusions (R. 142-148) and filed objections to the proposed findings and conclusions submitted by defendants (R. 155-156), it never suggested any provision about application of rentals. If Raytheon's new counsel had any question about the meaning of the judgment on this score, they should have applied to the District Court under paragraph 4 of its judgment which reserved jurisdiction to resolve any further controversies that might arise in the application of the judgment, rather than trouble this Court with a non-existent issue.

2. Raytheon's brief (at p. 41) contains one paragraph asserting that "incidentally" the judgment erred in failing to provide for reduction of the purchase price for any assets which should prove undeliverable. *But its notice of appeal did not appeal from any such omission.* Moreover, there was no contention or evidence offered at the trial that any of the assets were missing. Raytheon had been in possession of the plant for nearly 6 months at the time of trial and, if any of the equipment was missing, should have known and introduced evidence thereof. The findings and conclusions were not signed until June 4, 1962 (R. 164) or the judgment until June 11, 1962 (R. 168), all after the June 1st date when the assets were deliverable under Manufacturing's offer. Raytheon prepared proposed findings and conclusions (R. 142) and objections to defendant's counterdraft as late as May 28th (R. 155, 156) and made no suggestion of missing assets or of any facts supporting a price reduction.

B. Appeal from Paragraph 4 of the Judgment Relative to Reservation of Power to Substitute Appraiser.

This matter, argued by Raytheon (at p. 51 of its brief) is moot (as well as a false issue) because defendants have accepted American Appraisal Company. Raytheon and Semiconductor have already submitted to it the appraisal of the Group 2 assets, and its appraisal has been made and reported, although Raytheon

has declined to abide by that appraisal pending its appeal from paragraph 3 of the judgment.[40]

Argument of Rheem Manufacturing Company and Rheem Semiconductor Corporation As Appellants on Cross-Appeal

I. The Facts.

The underlying facts are stated at pages 18, 20, 21 above. Manufacturing and Semiconductor appealed (R. 171) only from paragraph 2 of the judgment which adjudged (R. 166):

> "The notice given by plaintiff Raytheon Company to defendant Rheem Semiconductor Corporation by letter of February 2, 1962 (a copy of which is attached to the complaint herein as Exhibit 7), * * * was a sufficient exercise of its right of first refusal with respect to the items included in the said offer from defendant Rheem Manufacturing Company to defendant Rheem Semiconductor Corporation, and gave

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40. The provision in paragraph 4 was a perfectly valid one. It did not disqualify American Appraisal Co. but simply reserved jurisdiction to entertain an application to hear and determine whether good cause for disqualifiation existed. Courts of equity have inherent power to mold their decrees to the exigencies of the case. *Hecht v. Bowles,* 321 U.S. 321, 329. Independently of statute or directions in a trust instrument, a court has jurisdiction to supplant an unsuitable trustee, once jurisdiction of the trust is given to it. 4 Pomeroy's Equity Jurisprudence (5th ed.) § 1086, p. 256; *Boone v. Wachovia Bank etc. Co.,* 163 F.2d 809, 814 (D.C. Cir.). A court may supplant an arbitrator appointed by a party once its jurisdiction to enforce arbitration is invoked. *Cathcart v. Security Title Ins. etc. Co.,* 66 C.A. 2d 469, 152 P.2d 336, and, of course, the provision for an appraiser was one for arbitration of value, the appraiser thus being an arbitrator. The jurisdiction of a court of equity having been invoked over an aspect of arbitration, it could reserve jurisdiction to do whatever became appropriate for proper execution of its judgment.

rise to a valid binding contract between plaintiff Raytheon Company and defendant Rheem Semiconductor Corporation whereby said defendant Rheem Semiconductor Corporation became bound to sell and plaintiff Raytheon Company became bound to buy said assets for $531,584, payable by February 17, 1962, and, in consequence, title to said assets covered by said offer vested in plaintiff Raytheon Company on February 2, 1962."

II. The Issue: A Pure Question of Law.

Raytheon based its claim that it had exercised its right of first refusal *solely* on its letter of February 2, 1962 (R. 112), and said that it had no other evidence of exercise (R. Tr. 27:17; R. Tr. 28:16). The question is the elementary contract question of "offer and acceptance". Semiconductor's letter to Raytheon of January 26, 1962 (Exhibit 5 to the complaint, R. 106), which notified Raytheon of Manufacturing's offer, was, of course, an offer to sell the assets to Raytheon for $531,584. The terms of the offer were:

> "* * * you shall have the period of time specified therein [in Section 12 of the lease, i.e., 5 days] to purchase all of the items covered by such offer at the price specified above [i.e., $531,584] * * *." (R. 106, 107).

The sole question on the cross-appeal is : Was this offer accepted by Raytheon's letter of February 2, 1962? Whether a writing constitutes an acceptance, so as to create a contract, is a pure question of law to be decided by an appellate court unfettered by the determination of the trial court. *Wristen v. Bowles,* 82 Cal. 84, 22 Pac. 1136; *Rothstein v. Edwards,* 94 F.2d 488 (9 Cir. 1937); *Philip Wolf & Co. v. King & Starrett,* 1 Cal. App. 749, 82 Pac. 1055. Thus, unlike the issues raised by Raytheon's appeal, the issue on the cross-appeal is purely a question of law.[1]

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1. Defendants so submitted from the outset of the litigation (R. Tr. 46, proceedings at first hearing; R. Tr. 28, 29).

III. Discussion: Raytheon's Letter Was Not an Unqualified acceptance but a Rejection Asserting That the Offer Was a Nullity.

Raytheon's letter in full text is this (R. 112):

> "Reference is made to the Lease Agreement dated November 30, 1961 between Rheem Semiconductor Corporation and Raytheon Company and particularly to Paragraph 12 of said Lease Agreement.
>
> "Raytheon Company hereby notifies you that it unconditionally makes the election and exercises its rights pursuant to said Paragraph 12 to purchase the items of equipment listed on Exhibit 'A' attached hereto.
>
> *It is necessary that the price of the items hereby purchased be determined. As you know, it is our position that no bona fide offer has been received by you for any of the items listed and that the price will be determined pursuant to other provisions of the agreement.*"

The sentence beginning "As you know" is a reference to Raytheon's letter to Semiconductor of January 23, 1962 (Ex. 4 to Complaint, R. 104), wherein Raytheon said:

> "such notice is *of no effect* in that an offer by your parent cannot be treated as a 'bona fide offer' * * *."

California law controls the question, and Cal. Civ. Code § 1585 states:

> "Acceptance must be absolute. An acceptance must be absolute and unqualified, or must include in itself an acceptance of that character which the proposer can separate from the rest, and which will conclude[2] the person accepting. A qualified acceptance is a new proposal."

In short, the question is whether Raytheon's letter of February 2, 1962 was an absolute and unqualified acceptance of an offer to sell for $531,584.00, i.e., an absolute and unqualified consent to pay that sum.

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2. Deering's 1961 one volume unannotated edition of the Civil Code erroneously has "include". The correct word is "conclude".

We submit that it was obviously not. It asserted that *Manufacturing's offer was a nullity, and that there was no obligation to meet the price of $531,584* in order to acquire the assets. To be sure, it asserted that it was exercising a right to buy, but the right *it presumed* to exercise was a non-existent right to buy under the other provisions of Section 12, applicable only where no offer from another had been received,—the provisions under which Raytheon could elect to buy, absent an agreement on price, at 90% of book value or at a price appraised by American Appraisal Co., whichever was lower. But Raytheon did not have the kind of right it so sought to exercise because, as the District Court adjudged, Manufacturing's offer was a valid one. Raytheon's letter plainly said that the price it was willing to pay was one which it was *"necessary"* to *"be determined"* and that "the price *will be* determined pursuant to other provisions of the agreement". This was not a consent to pay $531,584, without which there was no exercise of the right of first refusal.

The gist of Raytheon's argument below was that by this letter Raytheon said, "We will unconditionally buy the assets and we will pay $531,584 *if, as the result of litigation,* a court holds that we have to." But an acceptance qualified by the condition that the other party must first litigate and win a lawsuit clear through the Court of Appeals cannot rationally be called "absolute or unqualified". It is not an acceptance that, in the language of Civil Code § 1585, "concludes" the acceptor, for it makes clear that he is not willing to be concluded without losing a lawsuit.

Raytheon characterized the meaning of its letter of February 2, 1962 in the following colloquy at the first hearing in this case (on application for a temporary injunction) (R. Tr. 661):

> "THE COURT: What are you willing to pay for the assets?
>
> "MR. WHEAT: Whatever the option works out to. We don't know what the figure is. We are willing to pay what the parent company has offered, if their offer is bona fide. We don't know whether it is bona fide.

"MR. LASKY: Apart from the question of bona fides of that offer, *is Raytheon willing to match that offer of five hundred and thirty-odd thousand? Now?*

"MR. WHEAT: *If* the offer is held by the Court to be bona fide, unqualifiedly yes. *But we are not willing to pay that offer if it is what we think it is, simply a commercial gimmick.*"

We submit that it defies reason to call this an unqualified acceptance.

This Court's decision in *United States v. T. W. Corder, Inc.*, 208 F.2d 411 (9 Cir., 1953) is exactly in point. There T. W. Corder, Inc. leased a lot and building to the United States with an option to the lessee "to purchase the leased premises at not to exceed $75,000." (p. 411). During the term of the lease the lessee sent a telegram to the lessor reading (p. 412):

> " 'The United States of America by this notice elects to and hereby does accept the option to purchase the Corder Building in the City of Oakland, County of Alameda, State of California, and the land site thereof described * * * [description omitted]. The option hereby accepted is contained in lease contract [identification of the lease here omitted]. Upon receipt of confirmation letter which follows, kindly advise this office the least sum of money you will accept for conveyance of fee title of the above described property (11 CBA)' ".

In answer to the Government's request for advice of the minimum price for the property, the lessor stated that it would "positively accept no less than $75,000.00 net to us" (p. 412). The Government then claimed that it had overpaid 3 days' rent. The lessor successfully sued for nonpayment of rent and to terminate the lease. The Government then sued to condemn the property and claimed that the price should be $75,000 under its option. A judgment for $95,000 as the fair market value was affirmed, this Court saying (p. 413):

"The option price was not to exceed $75,000.00, but at no time did the Government unequivocably offer to purchase the property in accordance with its terms. The telegram of June 27, 1947, was not an acceptance of the option but was mere notice that the Government wished to exercise its option and a request that appellee advise it of the lowest price appellee would accept for the property. Appellee notified the Government that it would accept no less than $75,000.00. From the stipulation it clearly appears that the Government never made an unconditional offer to pay $75,000.00 for the property. It at all times insisted that it had the right to deduct the alleged overpayment of three days rent. As a result of the failure to exercise the option in acordance with its terms no bilateral contract for the purchase of the property came into existence. To exercise an option the notice thereof 'must be unconditional and in exact accord with the terms of the option.' 1 Corbin on Contracts, § 264, p. 879; Colyear v. Tobriner, 1936, 7 Cal. 2d 735, 62 P.2d 741, 109 A.L.R. 191. The Government was at no time bound by its conditional acceptance of the option and appellee was not bound because the option had not been exercised."

The last passage in this quotation poses a testing question. Raytheon's own official testified that technology in electronics manufacturing changes so rapidly that equipment could become obsolete quickly (R. Tr. 193). Suppose the equipment in controversy had become outmoded and valueless, and Semiconductor were suing Raytheon and contending that by its letter Raytheon had bound itself to buy it for $531,500. Could Semiconductor successfully contend that there was such a contract? The answer, we submit, is obviously "no".

In *Colyear v. Tobriner*, 7 C.2d 735, 62 P.2d 741 (1936), a lease contained an option to renew at a rental not to exceed a 20% increase. The lessee wrote to the owner's agent that (p. 738) "it is our intention, and you may consider this a notice,

that we will exercise our option * * *." Three days later the lessee wrote again (p. 738):

> " 'This will be a notice that we will renew the lease by exercising our option on the expiration date, May the 9th, and we assume the monthly rental will remain the same, as conditions do not warrant any change, as I think you will agree.' "

The owner refused this offer to pay the same rental and demanded the 20% increase. The court held that the option had not been exercised, because, although the lessee in both letters stated that he exercised the option, the second letter "is qualified by this statement: 'We assume the monthly rental will remain the same, as conditions do not warrant any change, as I think you will agree.' " (p. 739)

In *Hayward Lbr. & Inv. Co. v. Const. Prod. Corp.*, 117 C.A. 2d 221, 255 P.2d 473 (1953), the court said that to avail himself of an option,

> "tenant must apprise the lessor in unequivocal terms of his unqualified intention to exercise his option in the precise terms permitted by the lease." (p. 227, 228)
>
> "* * * An option is an offer by which a promisor binds himself in advance to make a contract if the optionee accepts upon the terms and within the time designated in the option. Since the optionor is bound while the optionee is free to accept or not as he chooses, courts are strict in holding an optionee to exact compliance with the terms of the option." (p. 229)

In *Jones v. Moncrief-Cook Co.*, 250 Okl. 856, 108 Pac. 403, involving an option to the lessee to buy the property "at the price offered by any other purchaser", lessor received an offer of $3100 and advised the lessee by telegram. The lessee replied by letter (108 Pac. 404, 405). It expressed surprise that such a price had been offered, added "of course we may be able to

make some arrangements with you for the purchase of the lot," asked for the lessor's "best terms of payment" by return mail and argued that for several reasons a payment of $2800 or less by the lessee would net the lessor as much as a payment of $3100 by a third party. It concluded: "Kindly advise us if you could take something like $500.00 or $800.00 down, the balance in 3 installments of one, two and three years each. If you could make us a good proposition, we might be able to handle the deal for you. As said above we will take the matter up with our partners, by which time we hope to again hear from you.'" Four days later the lessee wired the lessor that it would pay the $3100. It was held that lessee's first letter "amounted to a refusal to purchase at the price offered, to wit, $3,100", because a "counter offer amounts to a rejection under the option of the terms proposed, being an effort to make a new contract" (108 Pac. 40) and because the optionee should not be "permitted to carry on a system of diplomatic correspondence with the lessor." (p. 406).

IV. The Relief to which Cross Appellants Are Entitled.

Since Raytheon did not exercise its right of first refusal, it had no right to buy the assets, and its retention of possession after the end of the lease term has been a wrongful conversion, effected as of June 1, 1962. Cal. Civ. Code § 3336 provides:

> "The detriment caused by the wrongful conversion of personal property is presumed to be:
>
> "First—The value of the property at the time of the conversion, with the interest from that time, or, an amount sufficient to indemnify the party injured for the loss which is the natural, reasonable and proximate result of the wrongful act complained of and which a proper degree of prudence on his part would not have averted; and
>
> "Second—A fair compensation for the time and money properly expended in pursuit of the property."

Manufacturing, the purchaser and owner of the property, is therefore entitled to damages for its value as of June 1, 1962, plus interest from that time plus fair compensation for the time and money expended in pursuit of the property. Paragraph 2 of the judgment should therefore be reversed with directions to the District Court to determine and award judgment for the amount of these damages.

CONCLUSION

We respectfully submit that those portions of the judgment from which Raytheon appeals should be affirmed, and that paragraph 2 of the judgment should be reversed with directions to the District Court as just suggested above.

Dated: San Francisco, California, February 21, 1963.

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Attorneys for Appellees and Cross-Appellants Rheem Manufacturing Company and Rheem Semiconductor Corporation.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

MOSES LASKY

No. 18,257

IN THE

United States Court of Appeals

For the Ninth Circuit

RAYTHEON COMPANY, a corporation,
Appellant and Cross-appellee,

vs.

RHEEM MANUFACTURING COMPANY, a corporation, and RHEEM SEMICONDUCTOR CORPORATION, a corporation,
Appellees and Cross-appellants.

Reply Brief of Rheem Manufacturing Company and Rheem Semiconductor Corporation as Appellants on Cross-Appeal

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SUBJECT INDEX

INDEX OF AUTHORITIES

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Raytheon asserts, astonishingly (Br. 3, 4, fn. 2),[1] that it is not "clear in what respects cross-appellants contend the court below erred" because our brief on the cross-appeal "does not contain a specification of errors as required by Rule 18, par. 2(d) of this

1. All references to Raytheon's brief are to its brief as Cross-Appellee.

Court." But the nature of our claim of error was stated with exactness and precision.[2] If it lacked anything, it was only the formal rubric "specification of error". But the purpose of this Court's Rule 18, par. 2(d) is to enable the Court to see what issues are submitted to it; it serves no ritualistic end.[3] Nevertheless, as was recognized as permissible in *Greyhound Corp. v. Blakley*, 262 F.2d 401, 407, 409 (9 Cir. 1958), to remove even the slightest basis for criticism we now state one.

Specification of Error

The District Court erred in concluding, in stating its conclusion as a finding, and in adjudging, that Raytheon's notice of February 2, 1962 (a copy of which is attached to the complaint as Exhibit 7) exercised its right of first refusal with respect to the items included in the offer of Manufacturing to Semiconductor, and gave rise to a valid binding contract between Raytheon and Semiconductor whereby Semiconductor became bound to sell said assets to Raytheon for

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2. The sole issue on the cross-appeal was stated at pp. 22 and 26 of the single brief filed by us as appellees and cross-appellants. On the *very first* of the 9 pages entitled the Argument on the cross-appeal (p. 70) we stated that our appeal was solely from that part of the judgment (there quoted) which adjudged that the notice given by Raytheon to Semiconductor on February 2, 1962 (Ex. 7 to complaint) was a sufficient exercise of its right of first refusal, gave rise to a binding contract to buy and sell for $531,584, and vested title in Raytheon. This had been plainly stated in our notice of appeal itself (R. 171). On the *second* of the 9 pages we said that Semiconductor's letter of January 26, 1962 to Raytheon (Exhibit 5 to complaint), notifying Raytheon of Manufacturing's offer, was an offer to sell the assets to Raytheon for $531,584, that

> "The sole question on the cross-appeal is: Was this offer accepted by Raytheon's letter of February 2, 1962?"

and that this issue is purely a question of law.

3. *Brotherhood of Locomotive F. & E. v. Butte, A. & P. Ry. Co.*, 286 F.2d 706, 710 (9 Cir. 1961); *Empire Printing Company v. Roden*, 247 F.2d 8, 15, 16 (9 Cir. 1957); *D'Aquino v. United States*, 192 F.2d 338, 348 (9 Cir. 1951).

$531,584, or any other sum, and that in consequence title to the assets vested in Raytheon.[4]

DISCUSSION

Raytheon's brief does not deny any of the following statements made in our brief:

1. Semiconductor's letter of January 26, 1962 notifying Raytheon of Manufacturing's offer was an offer to sell the assets to Raytheon for $531,584, if accepted within 5 days.

2. The issue is one of offer and acceptance, viz., was Raytheon's letter of February 2, 1962 an acceptance of that offer of Semiconductor's?

3. This is a pure question of law.

4. An acceptance must be unconditional.

The essential fallacy in Raytheon's argument is that it ignores the fact that the lease gave Raytheon *two distinct and different options* to buy assets, and these two options were not alternatives at the choice of Raytheon, but each existed only if the other did not. If Semiconductor had a bona fide offer from another, Raytheon had a five-day option to purchase by matching the other's price. In the absence of such an offer from another, Raytheon had an option to buy at a price differently determined.

Raytheon's brief treats these two different options as one option and in effect argues that it exercised its option, gliding over

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4. This specification is itself but a compressed version of the "statement of points on which [we] intend to rely on [our] cross-appeal" (R. 172) where we stated that we "intend to rely on the following point on [our] appeal, namely, that the notice given by plaintiff Raytheon Company to Rheem Semiconductor Corporation by its letter of February 2, 1962, a copy of which is attached to the complaint as Exhibit 7, was not an exercise of the right of first refusal of Raytheon Company with respect to the items included in the offer from defendant Rheem Manufacturing Company to defendant Rheem Semiconductor Corporation, did not give rise to a valid binding contract between plaintiff Raytheon Company and defendant Rheem Semiconductor Corporation, whereby said defendant Rheem Semiconductor Corporation became bound to sell said assets at all and that in consequence title to said assets covered by said offer did not vest in plaintiff Raytheon Company at any time."

the fact that it declined to exercise the only option open to it and sought to exercise the option that was not available.

The gist of its argument is that its letter of February 2, 1962, unequivocally agreed to buy the assets at whatever price was required—the amount offered by Manufacturing if Manufacturing's offer was valid, or, if Manufacturing's offer was not valid, at a price differently determined. To this there are two separate answers:

First: Raytheon's letter of February 2, 1962 cannot fairly be so construed. It *did* say that Raytheon elected to buy the assets, but it did *not* say that it would do so for $531,584 if necessary. It plainly said that the price it would pay would have to be determined pursuant to other provisions of the agreement. It did *not* say that, if the other provisions were not applicable, Raytheon committed itself to pay $531,584.

Second: Even if the letter were construed as Raytheon now wishes it, it would not have been an unqualified acceptance of *Semiconductor's* offer. Here Raytheon's argument, just as it merges two options, confuses two different offers. One was an offer *by Manufacturing* to buy *from Semiconductor.* The other was an offer *by Semiconductor* to sell *to Raytheon,* comprised in its notice. Regardless of whether or not a court of law should *later* hold that *Manufacturing's* offer was "bona fide", *Semiconductor's offer* to Raytheon was an offer to sell at $531,584 *and at no other price.* It is true that *if* Manufacturing's offer were not "bona fide", Raytheon could have ignored Semiconductor's offer. But Manufacturing's offer was bona fide, as has now been adjudged, and therefore Raytheon could purchase *only by unqualifiedly accepting the precise offer made by Semiconductor.* It had to make its choice. It had no right to hedge. Raytheon states (Br. p. 2) that, "Unquestionably Raytheon had a right to question the bona fides of the offer [of Manufacturing]." Unquestionably so. But in doing so, it took the risks of finding itself in error. It could

not fasten that risk on to Semiconductor and thus possess the best of both worlds, as it consistently has tried to do in every phase of the case. Raytheon continues (Br. pp. 2, 3), "Even while raising the question, its election to purchase in accordance with the provisions of the contract was unconditional." But this statement contains the vice of ignoring that there were two different and mutually exclusive option provisions of the lease.[5]

Raytheon argues that "that is certain which can be made certain" (Br. p. 3) and thereby apparently seeks to evade the obvious truth of the submission in our brief (p. 73), that "an acceptance qualified by the condition that the other party must first litigate and win a lawsuit clear through the Court of Appeals cannot rationally be called 'absolute or unqualified' ". But *there was no need for anything to be made certain. Semiconductor's offer was as certain as certain can be as to price, viz.,* $531,584. Litigation was not necessary to make this certain. Litigation followed because Raytheon sought a judgment that it was entitled to ignore *Semiconductor's offer* and exercise *the other option.*

Raytheon's final argument (Br. 4-6) is that if an offeree, in stating his acceptance of the offer, expresses a term of the contract that would exist even were it not expressed in words, he does not thereby lessen the absolute nature of his acceptance. This is an obvious truism, for in such a case the express statement in the acceptance neither adds nor subtracts anything from the *terms of the contract which the unconditional acceptance of the offer brings into being. But the truism is not applicable here.* The plain distinction is between expressing a term or condition

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5. The sliding character of Raytheon's argument is also illustrated by its next paragraph (Br. p. 3);

> "The mere suggestion that Rheem and/or Semiconductor would cut off Raytheon's rights by an artificial offer at an impossibly high price—if the offer should eventually be held to be not bona fide—implies that this Court could condone a fraud."

If Manufacturing's offer were held not to be bona fide, the question raised by the cross-appeal would not be present. Semiconductor's offer of January 26, 1962 would have been a nullity.

of the contract that comes into being by the *unqualified acceptance*, on the one hand, and imposing a condition on the acceptance, on the other. Here, if Raytheon's letter of reply to *Semiconductor's offer* to sell for $531,584 can be construed as a willingness to pay $531,584 in any circumstance, it placed on that statement the condition that first the parties had to litigate until a court of law should adjudge that Manufacturing's offer was a bona fide offer.

Here, just as Raytheon's argument confuses the existence of two options and two offers, it uses the word "contract" to refer to two different things. There was the contract which gave Raytheon its options, i.e., the lease. And there is the contract of purchase and sale that would have come into existence if Raytheon had validly exercised the option available to it. Raytheon's letter of February 2, 1962 did not attempt to state any term that would be present in the contract of purchase and sale that would have come into existence *if* Raytheon had unqualifiedly accepted Semiconductor's offer. What it did was to assert what it believed to be its rights under the contract of lease—a belief that turned out to be mistaken.

Raytheon (Br. 6, 7) tries to distinguish the cases cited by us, but those cases speak for themselves.

The Relief to Which Cross-Appellants Are Entitled

Finally, Raytheon asserts (Br. p. 8, fn. 3) that "Rheem's contention that it is entitled to damages for wrongful conversion of the list 'B' assets that were the subject of its offer is *frivolous*", because the judgment below declared that title to the assets had vested in Raytheon in February 1962, adding, blandly, that one cannot be guilty of conversion of property to which it has title! True, one cannot, but our claim to damages is predicated on the submission that this part of the judgment must be reversed on our cross-appeal. Raytheon will then have been in possession, *without title*, of the assets for in excess of a year after any right to possession was ended by termination of its lease. Indeed, it

will have been in possession of the assets while not even offering to pay the $531,584 which the judgment adjudicated that it had to pay for the title it purported to declare. Raytheon's belief, however honest, that it had title is no defense. 48 Cal. Jur. 2d Sec. 3, p. 537; Sec. 32, p. 574. "A mistake of law or fact is no defense. 'Persons deal with the property in chattels or exercise acts of ownership over them at their peril' ", Prosser, The Law of Torts, 71 (2 ed. 1955). Frivolity lies in the contention that Raytheon could hold property under an erroneous claim of title and yet escape any liability, and in the further assertion that cross-appellants did not obtain a "stay". There was no way Manufacturing could oust Raytheon of possession without first obtaining a reversal, on this cross-appeal, of the portion of the judgment from which it has appealed. No "stay" can be conceived of which would do so.

Here, as in so many aspects of this case, Raytheon's attitude is that "heads I win and tails you lose"; that it never committed itself to anything, never had to take any risk that its positions and conduct might be in error; that it would profit if it were right but would suffer nothing if it were wrong.

CONCLUSION

We respectfully submit that paragraph 2 of the judgment should be reversed, with directions to the District Court to determine and award judgment for Manufacturing in the amount of the damages occasioned by Raytheon's conversion of the assets.

Dated: June 3, 1963.

MOSES LASKY
BROBECK, PHLEGER & HARRISON
Attorneys for Appellants on Cross-appeal

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

MOSES LASKY

No. 18,257

In the

United States Court of Appeals

For the Ninth Circuit

RAYTHEON COMPANY, a corporation,
Appellant and Cross-appellee,

vs.

RHEEM MANUFACTURING COMPANY, a corporation, and RHEEM SEMICONDUCTOR CORPORATION, a corporation,
Appellees and Cross-appellants.

Petition of Appellees for Rehearing

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No. 18,257

In the

United States Court of Appeals

For the Ninth Circuit

RAYTHEON COMPANY, a corporation,
Appellant and Cross-appellee,
vs.
RHEEM MANUFACTURING COMPANY, a corporation, and RHEEM SEMICONDUCTOR CORPORATION, a corporation,
Appellees and Cross-appellants.

Petition of Appellees for Rehearing

Appellees respectfully petition for a rehearing on the following grounds.

I.

THE DECISION THAT MANUFACTURING'S OFFER WAS NOT "BONA FIDE" RESTS ON AN ASSUMPTION ABOUT THE MEANING OF THE CONTRACT CONTRARY TO THE TRIAL COURT'S INTERPRETATION FULLY SUPPORTED BY EXTRINSIC EVIDENCE

Basic to the decision (Op. 9, 12, 14) is the holding that, while Manufacturing had a right under the contract to make an offer, it could not do so if the purpose or effect was to "deprive Raytheon of its purchase rights". But this idea rests on an assumption of what rights the contract gave Raytheon that (a) *begs the question,* and (b) *sub silentio* assumes an answer to the second issue of the

case which, when it came to it, the Court has held that it may not decide at all.

The assumption reads into the contract a proviso that Raytheon had a right to purchase assets at distress value—i.e., at a price giving *no* consideration to the value to Raytheon but determined on the basis that Raytheon had decided not to buy, had eliminated itself from the group of possible buyers, and had ripped the items from the plant and placed them on the loading dock for removal.

The contract does *not* expressly so provide,[1] and from its words alone it would be *at least* as logical to say that Raytheon's right was subordinate to Manufacturing's right to offer, rather than the reverse, particularly since (a) one's rights under a contract are not derived from any isolated clause, and (b) Raytheon's right to buy at an appraised price arose only *if* no offer from another had been received.[2] Moreover, *at best,* Raytheon had no right to buy for less than "fair market value" as the parties *intended* that term. Thus, in *two* respects, the problem is one of contract interpretation. Under California law,[3] the contract must be construed in the setting of its extrinsic evidence,[4] and the interpretation is an issue of fact,[5] being a process of factual inference, wherein an appellate court may not supplant a trial court's interpretation by inferences which seem to it more probable,[6] particularly where to do so is to "find a more sinister cast [here bad faith] to actions

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1. The only reference to loading dock is in the clause (¶ 5) providing what should be done at the termination of the lease with respect to such of the items as Raytheon did not want (R. 54).

2. The lease does not even reach its provisions about an option to buy at an appraised price until after it states the "first refusal provision", and the whole clause (¶ 12, R. 57) is entitled "Right of First Refusal".

3. Which controls under the *Erie* doctrine, *Transcontinental Air v. Koppal,* 345 U.S. 653, 656.

4. *Union Oil Co. v. Union Sugar Co.,* 31 C.2d 300, 305-306.

5. *Barham v. Barham,* 33 C.2d 416.

6. *Estate of Bristol,* 23 C.2d 221, 223; *Estate of Rule,* 25 C.2d 1, 11; *Walling v. General Industries Co.,* 330 U.S. 545, 550; *Quon v. Niagara Fire Ins. Co., of New York,* 190 F.2d 257 (9 Cir.).

which the District Court apparently deemed innocent", *United States v. Real Estate Boards*, 339 U.S. 485, 495.

On the first of the two aspects of interpretation, extrinsic evidence sustains the Trial Court's inference that Semiconductor's purpose in seeking the contract right for its parent to make an offer was to protect it against any effort of Raytheon to pick up the items at junk value and that Raytheon acquiesced in that protective clause since it had denied any such intention.[7]

On the second aspect of interpretation, Ellison's testimony sustains the Trial Court's finding that Manufacturing's offer was in the amount of "fair market value" as found by Ellison (Finding 15, R. 160; R. Tr. 628). This Court could come to a contrary view *only* on an *assumption* that the "fair market value" at which Raytheon might buy was dismounted, distress value, determined *as if* Raytheon had already rejected the items,—only *by rejecting* Ellison's opinion that "fair market value" required consideration of elements of value to Raytheon itself.

This Court postulates that Ellison made a first appraisal of "fair market value" in the range of $400,000 to $500,000, that Manufacturing "discarded" this, and obtained from him another, 34% higher than what Ellison deemed "fair market value". But Ellison's testimony is that he made but *one* appraisal, his different sets of figures representing *different* things. He flatly said that $531,584 was his appraisal of "fair market value" and that his lower range was *not*, but represented only an "on dock" figure of a used equipment dealer.[8] If, as the Court apparently thought, other parts of Ellison's testimony support a different view of his meaning, it is elementary that the internal reconcilia-

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7. Some of many items of such evidence (Our Br. 5, 6, 23, 67): (a) From the outset Semiconductor rejected Raytheon's offer of 30% of book value; yet the figures of $298,674 and $396,142 mentioned in the Opinion are in this 30% range. (b) Semiconductor had heard and Raytheon denied a rumor that Raytheon intended to "rook" it. (c) In the negotiations Raytheon stated it did not doubt that the items were worth *book value* if Raytheon needed them. (d) As Raytheon knew, the items were worth to it every cent of Manufacturing's offer.

8. R. Tr. 271: 21-272:9; 277:9-20; 299:9; 308:1-9; 309-310. Indeed, the higher figure was his response to request for an amount he should be prepared to pay himself (R. Tr. 298: 15-20).

tion of a witness's testimony is peculiarly the task of the trial court. Moreover, irrespective of Ellison's testimony, the testimony of Stroup—the man who sought and received Ellison's appraisal—is binding in this Court. *Nuelson v. Sorensen*, 293 F.2d 454, 460 (9 Cir.). He leaves no doubt that he acted on but one appraisal and that the offer was the amount he understood was Ellison's view of "fair market value" (R. Tr. 491:17-18; 492:18-493:20; 497:1-10; 498:22-499:20; 511:21-512:14).

The equipment was largely specialized items which had been installed at large cost by carefully engineered techniques. The contract provided (¶ 13, R. 58) that if Raytheon elected to purchase, it would acquire the items "in their then condition and their then location". The extrinsic evidence supports the Trial Court's interpretation that in determining "fair market value" at which Raytheon could buy, the parties *had in mind* the assets "in place" and not dismantled "on dock" (See our Brief, pp. 56-58).

II

ON THE QUESTION WHETHER THE MEANING OF THE TERM "FAIR MARKET VALUE" WAS FOR COURT OR APPRAISER

We have had no opportunity to brief this question because *all* the parties assumed that the meaning of the term was for court, not appraiser, and mutually submitted it to this and the lower court. If permitted, we can brief the question in less than 10 pages.[9]

1. Even where parties have agreed that an issue be non-judicially determined, the right to withhold that issue from the court disappears "by seeking without reservation a judicial determination of the issue," *Trubowitch v. Riverbank Canning Co.*, 30 C.2d 335, 339, *Local 659, etc. v. Color Corp.*, 47 C.2d 189, whether on principles of waiver, executed oral modification of the agreement (Cal. Civ. Code § 1698), or mutual rescission (Civil Code § 1689(a)).[10]

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9. Rule 23 precludes us from doing so in this petition.

10. Just so, the parties waived a general arbitration clause (Art. VI(2), R. 40) otherwise applicable to the issue of *bona fides* of Manufacturing's offer.

2. The provision for Raytheon to pay "fair market value" to be assessed by an appraiser stated the standard for him to follow. *Two* tasks are involved: not only to find the dollars and cents—a task peculiarly within an appraiser's expertise—but to determine what standard the parties meant by their words, a task peculiarly within the expertise of courts. *If* the contract assigned *both* tasks to an appraiser, the authorities cited in the opinion (pp. 16, 17) apply. But a preliminary question of contract interpretation is *always* for the court, to determine whether the parties did assign a particular issue to non-judicial determination, *Local 659, etc. v. Color Corp., supra,* at 195.

The strongest evidence of a contract's meaning, almost mandatory on a court, is the construction by conduct of the parties, although different from what the words seem to mean to the court, *Crestview Cemetery Ass'n v. Dieden,* 54 C.2d 744, 753, 754. The mutual submission to the court by all parties of the meaning of "fair market value" was *their* construction that by *their* contract *they* did *not* intend that issue for the appraiser. The Trial Court's decision of the issue was his interpretation to the same effect, which, being supported by the parties' own construction, cannot possibly be "clearly erroneous".

CONCLUSION

We respectfully pray that a rehearing be granted.

Dated: San Francisco, California, September 18, 1963.

MOSES LASKY
BROBECK, PHLEGER & HARRISON
Attorneys for appellees.

I certify that in my judgment the foregoing petition is well founded and that it is not interposed for delay.

MOSES LASKY

No. 18,258

In the United States Court of Appeals for the Ninth Circuit

McCULLOUGH TOOL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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INDEX

CITATIONS

Cases:

In the United States Court of Appeals for the Ninth Circuit

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On Petition for Review of the Decision of the Tax Court of the United States

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 32-48) is reported at 33 T.C. 743.

JURISDICTION

This petition for review (R. 52-54) involves federal excess profits taxes for the years 1951 and 1952. On January 9, 1957, the Commissioner of Internal Revenue mailed to the petitioner, McCullough Tool

Company, a notice of deficiency (R. 14-23) in the respective amounts of $104,690.01 and $86,898.80. Within ninety days thereafter and on April 8, 1957, the petitioner filed a petition with the Tax Court (R. 1-13) for redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. The decision of the Tax Court, determining deficiencies for the years 1951 and 1952 in the respective amounts of $126,104.46 and $740.52, was entered April 12, 1962. (R. 51.) The case is brought to this Court by a petition for review filed July 9, 1962. (R. 52-55.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether certain fixed amounts, which the petitioner-corporation (taxpayer herein) had agreed to pay under modification agreements which purported to convert two patent licensing agreements into sales of the patents, could, in computing its excess profits tax credit, be treated as "borrowed capital", within the meaning of Section 439 of the Internal Revenue Code of 1939, in that the agreement to pay these amounts represented an unconditional "outstanding indebtedness" which was evidenced by one of the types of instruments prescribed in the statute—specifically, here, a promissory note.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 436 [as added by Sec. 101, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137]. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

(a) *General Rule.*—In the case of a domestic corporation (except a corporation described in subsection (b)) the excess profits credit for any taxable year computed under this section shall be the sum of the following:

(1) The invested capital credit computed under section 437, reduced by the amount computed under section 440(b) (relating to inadmissible assets), and

* * * *

(26 U.S.C. 1952 ed., Sec. 436.)

SEC. 437 [as added by Sec. 101, Excess Profits Tax Act of 1950, *supra*]. INVESTED CAPITAL CREDIT.

(a) *Definition.*—The invested capital credit for any taxable year shall be the amount shown in the following table:

If the invested capital for such year (as defined in subsection (b)(1)) is:	The credit shall be:
Not over $5,000,000	12% of the invested capital.
Over $5,000,000 but not over $10,000,000	$600,000, plus 10% of the excess over $5,000,000.
Over $10,000,000	$1,100,000, plus 8% of the excess over $10,000,000.

(b) *Invested Capital.*—

(1) *Election of taxpayer.*—The invested capital for any taxable year shall be the adjusted invested capital determined under paragraph (2), except that if the taxpayer elects in its return for such taxable year to compute its invested capital under the provisions of section 458, the invested capital for such year shall be the historical invested capital determined under section 458. For the invested capital of certain insurance companies, see paragraph (3).

(2) *Adjusted invested capital.*—The adjusted invested capital for any taxable year (hereinafter in this paragraph referred to as "the taxable year") shall be the sum of—

* * * *

(C) 75 per centum of the average borrowed capital for the taxable year computed under section 439(a); and

* * * *

(26 U.S.C. 1952 ed., Sec. 437.)

SEC. 439 [as added by Sec. 101, Excess Profits Tax Act of 1950, *supra*]. BORROWED CAPITAL.

(a) *Average Borrowed Capital.*—For the purposes of this subchapter, the average borrowed capital for any taxable year shall be the aggregate of the daily borrowed capital for each day of such taxable year, divided by the number of days in such taxable year.

(b) *Daily Borrowed Capital.*—For the purposes of this subchapter, the daily borrowed capital for any day of any taxable year shall be

determined as of the beginning of such day and shall be the sum of the following:

> (1) The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebteness, mortgage, deed of trust, bank loan agreement, or conditional sales contract. * * *
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> * * * *

(26 U.S.C. 1952 ed., Sec. 439.)

STATEMENT

The facts as stipulated (R. 26-28) and found by the Tax Court (R. 33-41) are as follows:

The petitioner (hereafter referred to as taxpayer) is a corporation organized under the laws of the State of Nevada, with its principal place of business at Los Angeles, California. At all times pertinent herein 80 per cent of the stock of the taxpayer was owned by I. J. McCullough and 20 per cent was owned by his brother, O. J. McCullough. I. J. McCullough and O. J. McCullough are sometimes hereinafter referred to as the McCulloughs. (R. 33-34.)

Since its inception in 1941, the taxpayer has been and is now engaged in the rendition of perforating and other highly specialized services to the oil drilling industry. The business in which the taxpayer is engaged is highly competitive and approximately 75 per cent of such business is founded on a number of patents which it either owns or is licensed to use. (R. 34.)

Prior to January 1, 1944, the McCulloughs were the owners of certain patents (hereinafter referred to as the bullet patents) governing the manufacture, use, and sale of bullet-like projectiles for the perforation of oil wells. (R. 34.)

On January 1, 1944, the taxpayer and the McCulloughs entered into an agreement whereby the taxpayer received an exclusive license to make, use, and sell devices manufactured in accordance with the bullet patents. The agreement provided, *inter alia* (R. 34-36):

> 1.
>
> The Licensors hereby grant to the Licensee, upon and subject to the conditions, covenants, restrictions and terms hereinafter contained, the full and exclusive right and license during the continuance of this agreement to make, use and sell throughout the United States, its territories and possessions, devices made in accordance or disclosed in the aforesaid patents set forth on Exhibit A for the full term of said patents and until the expiration date of the last of said patents.
>
> 2.
>
> It is mutually understood and agreed that the license granted in Paragraph 1 hereof is granted subject to the condition that it does not and shall not empower the Licensee, directly or indirectly, to license any other person or persons, natural or artificial, to use said patents.
>
> * * * *

4.

The Licensee further agrees to keep books, records, and accounts of all work performed during the life of this agreement of all work done hereunder, and all such records or accounts shall at and during the usual business hours be open to the inspection of the Licensors or their duly authorized representative.

5.

On or before the 15th day of each calendar month after the execution hereof and during the continuance of this agreement, the Licensee shall mail a statement to each of the Licensors containing the information required in Paragraph 4, hereof, showing all charges for use and sales by the Licensee under this agreement during the next preceeding [sic] calendar month.

6.

In consideration of the rights and licenses herein given and granted by the Licensors to the Licensee, the Licensee agrees to pay to the Licensors at the time of rendering the statement required by Paragraph 5 hereof, a royalty consisting of a sum equal to twelve and one-half per cent (12½%) of the total gross price charged by the Licensee for all gun perforating done and all sales of parts and equipment in accordance with the herein license and patents, and one-fourth (¼) of the said royalty shall be paid to the Licensor O. J. McCULLOUGH and three-fourths (¾) of the said royalty shall be paid to the Licensor I. J. McCULLOUGH.

7.

The Licensee shall have the right to terminate this agreement upon first giving ninety day notice in writing to the Licensors to cancel and terminate this agreement together with all rights, licenses and obligations hereunder, provided, however, that no such termination or cancellation shall relieve the Licensee from the payment of any royalty due and payable to the Licensors at the time of such termination.

8.

In the event that either party shall violate any covenants of this agreement, the aggrieved party may give to the defaulting party written notice of such breach accompanied by sufficient particulars to reasonably enable the defaulting party to determine the alleged nature and extent of the breach, and if the defaulting party shall fail for a period of thirty days after the service of such notice to remedy such breach, the aggrieved party may, at its option, terminate and cancel this agreement and all of the rights and licenses of any defaulting party hereunder. The waiver of any particular breach or breaches by the aggrieved party shall not be deemed to constitute a waiver of any continuing breach or of any future breach by the defaulting party of this agreement.

On October 1, 1947, the taxpayer entered into an exclusive license agreement with Earl J. Robishaw and William G. Sweetman regarding several patent applications (hereinafter referred to as the jet patents) governing the manufacture, use, and sale of

shaped charges of explosives for the perforation of oil wells, devices sometimes known as jet perforators. The process of jet perforation of oil wells covered by the jet patents was not sufficiently developed at the time of the agreement to be commercially usable. The taxpayer under the agreement undertook the responsibility and expense of further development of the jet patents. In all other material respects the agreement was similar to the agreement for the bullet patents except as to the amount of royalty, the length of periods for notice of termination, and the transferability of the license. The agreement makes no mention of the right to grant sublicenses. (R. 36-37.)

Neither Robishaw nor Sweetman was an employee of the taxpayer on October 1, 1947. (R. 37.)

In July, 1948, each of the McCulloughs acquired a 25 per cent interest in the jet patents. At that time the jet patents were still not commercially usable. (R. 37.)

On December 28, 1950, the McCulloughs and the taxpayer executed a document entitled "Modification Agreement" which provided (R. 37-38):

> WHEREAS, the parties hereto on the first day of January, 1944 did make and enter into an Agreement by which the [McCulloughs] sold to the [taxpayer] certain patents and patent applications listed on Exhibit "A" attached thereto; and
>
> WHEREAS, said Agreement was termed a "License Agreement" and the parties thereto were referred to as Licensors and Licensee, respec-

tively, although the Agreement was intended to be, and, in law, was actually an agreement of sale; and

WHEREAS, Paragraph 6 of said Agreement provided for payments to the [McCulloughs], which payments were termed "royalty", of 12½% of the total gross price received by the [taxpayer] for services and sales under the said patents and patent applications; and

WHEREAS, the parties are desirous of modifying said provision for payment and substituting therefor a fixed and determinable total remaining price to be paid by the [taxpayer] in consideration for the sale of the said patents;

NOW, THEREFORE, in consideration of the mutual promises of the parties hereto, IT IS AGREED AS FOLLOWS:

1. Paragraph 6 of said Agreement of January 1, 1944 is modified to read as follows:

"6.

"In consideration of the rights in and to the patents and patent applications transferred, assigned and sold by the [McCulloughs] to the [taxpayer], the [taxpayer] hereby agrees to pay to the [McCulloughs], in addition to all other payments heretofore made hereunder, $20,000.00 per month on the 28th day of each calendar month, commencing on the 28th day of December, 1950, for a period of six years and one month. The last of said monthly payments shall be due and payable on the 28th day of December, 1956. One-fourth of each of

> said monthly payments, or $5,000.00, shall be paid to O. J. McCULLOUGH, and three-fourths of said monthly payments, or $15,000.00 shall be paid to I. J. McCULLOUGH. The parties are agreed that the total of these payments, $1,460,000.00, shall be the full remaining price to be paid by the [taxpayer] for the complete and absolute ownership of the patents and patent applications described in Exhibit "A"."
>
> 2. It is agreed by the parties hereto that any and all provisions of said Agreement of January 1, 1944 which are inconsistent with this Modification Agreement shall have no effect. Said Agreement of January 1, 1944 has been considered by the parties thereto as an absolute assignment or sale of the subject matter thereof. That Agreement together with this Modification thereof shall be similarly construed hereafter.

On December 28, 1950, the parties to the jet patent agreement or their assignees entered into similar modification agreements, the effect of which, *inter alia*, was to substitute the total price of $2,870,000 for the payment of a royalty. In all other respects the agreements were almost identical to the modification agreement relating to bullet patents. (R. 38.)

The taxpayer made all payments for the bullet patents due to McCulloughs under the modification agreement. The taxpayer's gross sales of parts and services under the bullet patents; the royalty payable thereon which would have been paid under the agreement of January 1, 1944; the actual payments under the modification agreement; and the excess

of the royalty payments which would have been paid under the agreement of January 1, 1944, over actual payments for the years 1950 to 1958, are as follows (R. 39):

Year	Sales	Royalty	Actual Payments	Excess
1950 (Dec. only)	.....	.....	$ 20,000.00	$ (20,000.00)
1951	$ 2,073,301.88	$ 259,162.74	240,000.00	19,162.74
1952	2,311,565.79	288,945.72	240,000.00	48,945.72
1953	2,908,134.84	363,516.86	240,000.00	123,516.86
1954	3,140,828.54	392,603.57	240,000.00	152,603.57
1955	3,268,037.83	408,504.73	240,000.00	168,504.73
1956	3,948,232.27	493,529.03	240,000.00	253,529.03
1957	2,688,173.28	336,021.66	.....	336,021.66
1958	2,250,591.30	281,323.91	.....	281,323.91
	$22,588,865.73	$2,823,608.22	$1,460,000.00	$1,363,608.22*

* Under the Modification Agreement of December 28, 1950, the fixed payment terminated December 1956. Under the prior License Agreement of January 1, 1944, the royalty payments would have continued until approximately 1968.

The taxpayer has made all payments for the jet patents due to the owners or assignees under the modification agreement. The taxpayer has made no attempt to terminate the agreement and in 1952 made advances to one of the parties of payments due for the five years next ensuing. The taxpayer's gross sales of parts and services under the jet patents; the royalty payable thereon if such royalty payments had been made under the agreement of October 1, 1947; the actual payments made under the modification agreement; and the excess of the royalty payments which would have been made under the contract of October 1, 1947, over actual payments for the years 1950 to 1958, are as follows (R. 39-40):

Year	Sales	Royalty	Actual Payments	Excess
1950 (Dec. only)	.....	.....	$ 14,000.00	$ (14,000.00)
1951	$ 2,391,904.25	$ 239,190.43	168,000.00	71,190.43
1952	2,953,871.53	295,387.15	168,000.00	127,387.15
1953	3,323,230.48	332,323.05	168,000.00	164,323.05
1954	3,478,612.41	347,861.24	168,000.00	179,861.24
1955	4,012,038.67	401,203.87	168,000.00	233,203.87
1956	4,490,768.51	449,076.85	168,000.00	281,076.85
1957	3,799,971.39	379,997.14	168,000.00	211,997.14
1958	3,569,073.75	356,907.38	168,000.00	188,907.38
	$28,019,470.99	$2,801,947.11	$1,358,000.00	$1,443,947.11

The Tax Court (R. 48) sustained the determination of the Commissioner that the taxpayer is not entitled to include its obligation under the modification agreements of 1950 as "borrowed capital" for the purpose of computing its excess profits tax credit. The taxpayer brings that decision here for review.

SUMMARY OF ARGUMENT

In order to qualify as "borrowed capital" under the provision of Section 439 of the Internal Revenue Code of 1939, and thus to be includible in the computation of the taxpayer's excess profits tax credit, an obligation of the taxpayer must be an unconditional outstanding obligation and it must be evidenced by one of the nine instruments named in the statute. The obligations created in the instant modification agreements of December, 1950, were neither.

It is well established, and apparently conceded by the taxpayer, that the existence of a right in the obligor to terminate the agreement out of which his obligation grows, and, thus, to abrogate any part

of the stated obligation destroys its nature as an unconditional obligation and excludes it from treatment as an "'outstanding obligation" within the meaning of the statute. Such a termination right was included as paragraph 7 of the original agreements of January 1, 1944, and October 1, 1947, and remained unchanged in the agreements as modified in December, 1950. The taxpayer seeks to avoid the condition which this imposes on its obligation by arguing that this right was abrogated by the blanket provision of the modification nullifying all provisions of the original agreement which were inconsistent with it . It is suggested by the taxpayer, without supporting authority, that a right of termination is, of necessity, inconsistent with an agreement of purchase ~~of~~ and sale. On the contrary, there is ample authority, both federal and state, to the effect that a contract for the sale of property may, and frequently does, contain a termination right (or its equivalent —the right to require the vendor to repurchase) running in favor of the vendee. Furthermore, the modification agreement itself is replete with attestation that the earlier agreements were, just as was the modification, intended as agreements of sale. It necessarily follows from this that the termination rights, having been made a part of the original agreements, were intended to condition an agreement of sale and cannot have been intended to be, or regarded as, in conflict with the modified agreements which merely reaffirmed the nature of the original agreements.

The obligation also falls short of qualifying as "borrowed capital" because not evidenced by one of the prescribed instruments. The contract giving rise to the obligation cannot constitute a "note", first, because the agreement to pay, contained therein, is not unconditional (one of the most definitive characteristics of a note) and, second, because a contract is not, by normal usage and terminology, a "note", the established rules of interpretation requiring that this be the standard by which this statutory term be construed.

ARGUMENT

The Amounts Which the Taxpayer Was To Pay Under the Modification Agreements Could Not Be Treated As "Borrowed Capital", Within the Meaning of Section 439 of the Internal Revenue Code of 1939 Since (1) They Did Not Represent An Unconditional Obligation and (2) Were Not Evidenced By One of the Types of Instruments Prescribed In the Statute

The issue before the Court centers about the proper computation of the taxpayer's excess profits tax liability for the years 1951 and 1952. Particularly, the question has to do with the excess profits tax credit which the taxpayer may use to reduce the amount of the net income against which the excess profits tax is charged. One of the elements which the taxpayer may include in developing its excess profits tax credit is the amount of its "borrowed capital", as defined in Section 439, *supra*. The instant litigation is immediately concerned with the provision of Section 439(b)(1) which provides that "borrowed capital" shall include:

> (1) The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust, bank loan agreement, or conditional sales contract. * * *

The taxpayer, a corporation which provided a service known as the perforation of oil wells, acquired the patent rights to two perforation devices (known as the "bullet" and the "jet") from several individuals. The "bullet" process was transferred to the taxpayer by the McCullough brothers, who were also the owners of 80 per cent of the taxpayer's stock. Both patents were initially acquired by what purported to be licensing agreements which were later modified by agreements designating the transfers as "sales" of the respective patent rights and converting the mode of payment from royalties, based upon the receipts produced by the patented devices, to fixed purchase prices, payable in installments over a five-year period. It is the contention of the taxpayer, rejected by both the Commissioner and the Tax Court, that the amount of the respective sale prices constitute "outstanding indebtedness" within the meaning of Section 439(b)(1), *supra*.

As pointed out by the Tax Court (R. 44) and agreed to by the taxpayer (Br. 14), in addition to being an "outstanding indebtedness", an obligation must be evidenced by one of the types of instruments named in Section 439(b)(1) in order to qualify as

"borrowed capital". The taxpayer contended below that the modification agreements, taken together with the earlier instruments which they modified, each constituted either a "note" or a "conditional sales contract"—these being two of the instruments named in the statute. The Tax Court held (R. 45-48) that they were neither and, having found them disqualified on that ground, did not undertake to determine whether or not they met the test of being "outstanding indebtedness". We submit that the Tax Court was correct in holding that the agreements did not constitute a "note" [1] and, moreover, that they did not represent "outstanding indebtedness" and were, thus, barred on both grounds from being treatable as "borrowed capital".

A. *The agreements did not constitute "outstanding indebtedness"*

The taxpayer concedes (Br. 15), citing cases, that, to be an "outstanding indebtedness" within the meaning of Section 439 (b) (1), an obligation must be unconditional—that is, it must be payable under all circumstances and subject to no contingency and no option, particularly on the part of the alleged debtor. Despite the contentions to the contrary by the taxpayer (Br. 16-19), the agreements here involved did not create an unconditional obligation on the part of the taxpayer to pay the amounts of $1,460,000 and $2,870,000, named, respectively, in the two modifica-

[1] The taxpayer does not renew before this Court the claim that the agreements amounted to a "conditional sales contract".

tion agreements of December 28, 1950. This is because the obligations in question were conditioned by the right of the taxpayer to terminate the agreement, at will, upon 90 days' written notice (par. 7, R. 36) and thus to abrogate any liability on its part to make any further payments under the agreement except those already *due and payable* at the time thereof. It is to be noted in this connection, that, under the modification agreement (R. 38), the full price was to be paid in monthly installments, that $20,000 was payable on the 28th of each month commencing on December 28, 1950, and that "The last of said monthly payments shall be *due and payable* on the 28th day of December 1956." (Emphasis added.) Consequently, the taxpayer had the option, at any time between December 28, 1950, and December 28, 1956, of relieving itself of the obligation to make any further monthly payments by giving written notice to the patentees of its intention to terminate the agreement.

The taxpayer seeks to avoid the effect of this provision by referring (Br. 17) to the language of paragraph 2 of the Modification Agreement (Br. 38) which reads:

> It is agreed by the parties hereto that any and all provisions of said Agreement of January 1, 1944 [and of that of October 1, 1947] which are inconsistent with this Modification Agreement shall have no effect.

It appears to be the taxpayer's contention (Br. 16-17) that, because the modification agreements pur-

ported to create a sale of the patents, the termination provisions of the earlier agreements became inconsistent therewith and were nullified by the above provision. This conclusion is entirely arbitrary and self-serving and the taxpayer makes no effort to show wherein lies the inconsistency. In fact, we submit, there is no inconsistency at all and as we shall show, the parties themselves obviously did not so regard or intend it at the time the agreements were drafted and executed.

1. The basis of the taxpayer's contention appears to rest upon the unspoken assumption that a contract of sale can never contain a provision for termination and that any such provision would, of necessity, be inconsistent with the concept of a sale. The taxpayer cites no authority in support of such an assumption. On the other hand, there is ample authority to the contrary. In *Myers* v. *Commissioner*, 6 T.C. 258, there was involved a contract using words of license similar to that contained in the original agreements in the instant case and, similarly, transferring all of the substantial rights inherent in the patent. The court, following the rule laid down by the Supreme Court in *Waterman* v. *Mackenzie*, 138 U.S. 252, held that this amounted to a sale of the patent. The agreement in the *Myers* case contained termination rights running to both parties. The right of the licensee was very similar to that here involved, providing (p. 260):

> 10. The Licensee shall have the right to terminate this agreement as to any letters patent

> included hereunder at any time after December 31, 1932, by sixty (60) days written notice mailed to the Licensor at his last known home address, or otherwise delivered to him, without, unless so specified by the Licensee, terminating it as to other letters patents included in the license herein granted, and the agreement and the license herein granted shall automatically terminate upon the expiration of all letters patents included hereunder, and/or upon the abandonment of any application included hereunder.

As to this, the Commissioner had contended (p. 264) that "The reservation of both the Licensor and the Licensee to terminate the agreement is incompatible with the claim that a sale was made." The court ruled (p. 264) that these were conditions subsequent which *did not interfere* with the passing of ownership.

This compatibility is reflected in the decisions of the state courts, including those of California. In a note in 44 A.L.R. 2d 343-344, dealing with provisions for repurchase by the vendor in contracts for the sale of property,[2] it is said that:

> It is clear that the parties to a contract for the sale of land, or to a conveyance of land, may validly provide, in the instrument of contract or conveyance, or by a contemporaneous writing, * * * that the vendee shall have an option to require the vendor to repurchase * * *.

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[2] There can be no difference, with respect to the question at hand, between the right to terminate or rescind and the right to require repurchase.

Hull v. *Angus*, 60 Ore. 95, 118 Pac. 284, 287, involved a conveyance of real property with part of the purchase price paid in cash and a note, secured by a mortgage, given for the balance. The note contained a proviso that made it liable to the terms of the mortgage and the latter reposed in the maker-mortgagor the right to cancel the sale and the note. This right was held to have destroyed the unconditional nature of the note and existed with respect to a purchase and sale transaction.

In *Hale* v. *Pendergrast*, 42 Cal. App. 104, 183 Pac. 833, 835, there had been a sale and conveyance of real property for $10,000 of which $2,000 was paid in cash and a note and mortgage issued for the $8,000 balance. The contract of sale provided that the vendee had the right within one year to demand that the vendor repurchase. The right was exercised within the time allowed but after the vendor had sold the note and mortgage to a third party without notice of the repurchase provisions. The latter ultimately brought suit against the vendee for the face amount of the note. The Supreme Court of California ruled in a *per curiam* opinion (pp. 110-111) that the assignee, although he might, because of the absence of notice to him, foreclose against the property, had no right to a deficiency judgment on the note. Thus, the termination or repurchase right was held valid, even in a contract of sale and conveyance, and its existence destroyed the unconditional nature of the promise to pay contained in the note.

In *Van Demark* v. *California Home Extension Ass'n*, 43 Cal. App. 685, 185 Pac. 866, it was recognized that a contract of sale may provide the vendee with a right to return the purchased property upon his own subjective determination that he is dissatisfied with it. Obviously, a note issued to the vendor in whole or partial payment for such property could not be unconditional in the face of such a provision —identical, in effect, with the right granted to the instant taxpayer by paragraph 7 of the original agreements of January 1, 1944, and October 1, 1947. See, to the same effect, *Bank of Claflin* v. *Rowlinson*, 2 Kan. App. 82, 43 Pac. 304.

2. It is clear from the terms of the several agreements that the termination provisions could not have been inconsistent with the terms of the modified agreements since the modifications made no change which affected those provisions. The "Whereas" clauses of the modification agreements (R. 37) recite that, by the earlier agreements, the patentees had "sold" the patents to the taxpayer, that they had been *intended* as agreements of *sale* and that, in law, they constituted such agreements. Since the modification agreements expressly provided for the same effect, there is no possible reason why the termination provisions should be any more inconsistent with them than with the original agreements of which they were a part. Further, if, as recited, the earlier agreements were *intended*, when executed, to effect a sale of the patents and the termination provisions were part of the instruments framed and executed to carry out this intent, it becomes obvious that they

were not then regarded as inconsistent with the purpose to effect a sale and conveyance. That being so, it is difficult to see how they could have been, or why they should be, regarded as inconsistent with the later agreement which purported to do, and did, nothing but affirm this purpose.

The final "Whereas" clause (R. 37) states that the purpose of the modification agreement is to substitute a fixed price for the existing payments which had been based upon the taxpayer's receipts from use of the patents. The agreement itself carries out this intent by changing only the language of paragraph 6 which deals with nothing but the mode of payment. Since the termination provision is equally consistent with any mode of payment, it cannot be inconsistent with the altered mode and the taxpayer makes no attempt to explain why it should be so regarded. In this respect, it may be noted that the very paragraph of the modification agreements (R. 38) which nullifies inconsistent provisions also reaffirms that the parties considered the earlier agreements (containing the termination provision) as of the same nature (agreements of sale) as the modified agreements.[3]

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[3] That the mere change in the mode of payment worked no real change in the nature and effect of the original agreements is emphasized by reference to the 1956 amendment (Act of June 29, 1956, c. 464, 70 Stat. 404) which added Section 117(q) to the 1939 Code and made retroactive to tax years beginning after May 31, 1950, the provisions of Section 1235 of the 1954 Code (26 U.S.C. 1958 ed., Sec. 1235). It is made clear there and in the Committee Report

Apart from the above, we submit that, had the parties to the modification agreements intended to effect so substantial a change as to eliminate the termination rights, they could easily, and would surely, have so provided in clear and specific language rather than through an uncertain reference to "all provisions * * * which are inconsistent".

The taxpayer suggests (Br. 19) that the ruling of the Tax Court (which is not brought here by the Commissioner for review) that it was entitled, under Section 23(l)(1) of the 1939 Code, to take depreciation deductions against its cost basis in the patent rights represents a determination that the modification agreements "established a fixed and unconditional obligation on the part of the [taxpayer]." The presumption implicit in this contention, and the above language, is that all fixed obligations are necessarily unconditional. We submit that this is not so. It should be noted that the Tax Court did not, with respect to this question, consider whether the obligation was or was not unconditional. (R. 41-43.) It stated the position of the Commissioner to be (R. 42) that depreciation was not allowable because the taxpayer did not have a *fixed* cost basis. The two terms operate independently and refer to different considerations. The term "fixed" refers to the determinability of the *amount* payable under an agree-

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accompanying the bill (H. Rep. No. 1607, 84th Cong., 1st Sess. (1956-2 Cum. Bull. 1226)) that the mode of payment for the rights to a patent are to have no bearing on the question of whether a given transfer of such rights constitutes a sale of the patent or a licensing arrangement.

ment. The term "conditional" refers to the degree of certainty or immutability attaching to the obligation to pay that amount. Thus, a licensing agreement, without termination rights, may establish an unconditional obligation to pay amounts which, because dependent upon variables, is not known or fixed. On the other hand, as in the instant situation, the amount may be known and thus "'fixed" but there may exist conditions in the agreement under which all or part of that amount may never become due and payable. There is nothing in the statutory provision for depreciation deductions which prohibits the depreciation of a cost basis in property because all or part of that cost might be remitted by the occurrence of a conditional contingency—upon the happenings of which any excessive depreciation deductions would presumably be taken into account in computing the tax consequences of the transaction by which the condition was made effective.

The Tax Court (R. 42) apparently interpreted the Commissioner's opposition to the allowance of depreciation to be on the ground that the 1950 modification agreement (and the fixed payment there provided) was a nullity because the "sale" there provided for had already taken place by operation of case law. It disposed of the issue on the sole conclusion (R. 42-43) that, even so, the surrender of the royalty payments and the assumption of the obligation to pay the fixed amount were mutually supporting considerations which established a valid modification to the agreement. The effect of the termination provision did not enter the picture.

Moreover, even if depreciation allowances were not deductible where a condition attaches to the taxpayer's obligation to pay the amounts established as the cost to it of the property, the validity and subsistence of the condition in the modified agreement is not open to question, as has been shown above. Therefore, the obligation could not amount to an "outstanding obligation" under the provision of Section 439(b)(1) and it would be necessary to conclude that the Tax Court had erred in allowing depreciation deductions to the taxpayer.

B. *The instruments which evidenced the taxpayer's obligations were not "notes"*

The Tax Court ruled (R. 47) that the taxpayer's obligations under the patent transfer agreements were not evidenced by a "note" within the meaning of Section 439(b)(1), *supra*, holding, apparently, that the issue was controlled by the rule in *Journal Publishing Co.* v. *Commissioner*, 3 T.C. 518, although recognizing that the contracts involved in the two cases were somewhat different.

As shown by the authorities cited by the taxpayer (Br. 20), a "note" creates an unconditional obligation to pay the named amount. In *Journal Publishing Co.* v. *Commissioner supra*, the parties had contracted for the sale to the taxpayer of certain physical assets of another publishing company and for a covenant by the latter not to compete. The contract provided for a $50,000 payment for the assets and $470,000 for the covenant. There, the Tax Court held that the taxpayer's obligation to pay the above

amounts did not amount to an unconditional promise and that the contract could not constitute a "note" for the purposes of Section 719(a)(1), the precursor provision to Section 439(b)(1).[4] In support of this holding, the court pointed to the fact that the promisee had a continuing obligation to refrain from the proscribed competitive activity and that failure to conform would relieve the taxpayer of its obligation to make payments. In the instant case, the taxpayer's right (as demonstrated in A, above) to terminate the agreement and, thereby, to discharge itself from the obligation to make further monthly payments, had, as recognized by the Tax Court, the same effect and placed conditions upon the taxpayer's agreement to pay. For this reason, alone, the Tax Court's holding that the composite agreement did not constitute a "note" was correct and should be sustained.

But, we submit, further, that a contract, whether unilateral or bilateral, is not a "note" within the normal usage of the latter term and, for that reason, is not comprehended within the coverage of that term as used in Section 439(b)(1). It has been frequently observed that the designation by the Congress of specific evidences of indebtedness in the statutory provision here involved, and in those in which simi-

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[4] Section 719(a)(1) was added to the Internal Revenue Code of 1939 by the Second Revenue Act of 1940, Section 201, c. 757, 54 Stat. 974, and repealed by Section 122(a), Revenue Act of 1945, c. 453, 59 Stat. 556. It was restored in substantially identical form by Section 101, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137.

lar language has been used, was intended to include only instruments of that precise nature and not others which, although sometimes similar in result, are known by other terms, and which Congress could have included had it wished to do so, either by specific designation or by use of general language which would also cover them. *Journal Publishing Co.* v. *Commissioner, supra; West Construction Co.* v. *Commissioner*, 7 T.C. 974; *Bernard Realty Co.* v. *United States*, 188 F. 2d 861 (C.A. 7th); *Consolidated Goldacres Co.* v. *Commissioner*, 165 F. 2d 542 (C.A. 10th). This was developed in considerable detail in *Journal Publishing Co., supra.* There the court pointed out (p. 522) that in other statutory provisions, and in Treasury Regulations, where, as here, the definition of "indebtedness" was involved and where the term was defined by listing the specific types which were to be covered, there was sometimes added the phrase "or other evidence of indebtedness", while in other instances it was omitted. The court then observed that, in Section 719(a)(1) (the World War II version of the section here involved), the Congress had omitted the general phrase and that, therefore (p. 523), "section 719(a)(1) must be applied in the instant case without the benefit of the additional phrase urged by the petitioner, * * * and that borrowed capital must be evidenced by the specific type of instruments set forth in the statute."

In *Consolidated Goldacres Co.* v. *Commissioner, supra.*, the Tenth Circuit announced (p. 545) that:

> * * * the Congress has deliberately chosen words to define the type of "outstanding indebtedness" which will be included in the excess profits credit, *and those words should be given their ordinary meaning in common usage.* (Emphasis added.)

This proposition has also been stated by the Seventh Circuit (*Bernard Realty Co.* v. *United States, supra*) which said (p. 864):

> * * * since Congress did not define "note" and "mortgage" in sec. 719, we hold it was intended that these terms be considered according to their ordinary legal acceptation.

The Seventh Circuit further ruled (p. 863) that:

> Taxpayer is claiming a credit or exemption, and is subject to the well established rule that a claimed credit, privilege or exemption from a tax cannot be granted unless specifically authorized by Congress, and that taxpayer must bring himself squarely within the terms of the authorizing statute.

We submit that a contract is not a "note" within the "ordinary meaning" of that term "in common usage" nor within the "ordinary legal acceptation", but rather is one of those "other written evidences of indebtedness" which were specifically omitted from the coverage of Section 719(a)(1) and its successor, Section 439(b)(1). To force a contract within the coverage of the term "note" is to violate the above-stated rule that a taxpayer seeking a credit against his taxes must bring himself *squarely* "within the terms of the authorizing statute."

It does not suffice that a contract, which does not have the same connotation as a "note" within the ordinary understanding and usage of the terms, may, in a given instance, posses most or all of the elements held essential in a "note". It remains, in essence, a contract and not a "note". Had Congress wished to confer status as a covered evidence of indebtedness upon any instrument having the characteristics or containing, by happenstance, all of the prescribed qualities of a note, it could readily have so provided through apt language. It is possible that this could have been accomplished through the inclusion of the oft-used phrase "or other written evidences of indebtedness". But, the Congress, in this instance chose not to do so. Had Congress wished to cover all evidences of unconditional indebtedness, it could have used *that* comprehensive expression instead of laboriously listing a certain group of covered instruments, many of which differ from others in only minor particulars. It must have been within the awareness of the legislature in drafting the instant measure that written, unilateral contracts frequently contain the elements of a note. Yet, although the Congress has seen fit, in Section 439(b)(1), to add the "conditional sales contract" to the list of qualifying evidences of indebtedness which had appeared in its predecessor, Section 719(a)(1), it has never listed contracts, generally, or any form thereof, except the special form above noted.

The Tenth Circuit, in *Consolidated Goldacres Co.* v. *Commissioner*, *supra*, pp. 545-546, said with respect to an instrument, denominated a conditional sales

contract, but which the taxpayer urged had all the characteristics of a mortgage (this case being governed by the provisions of Section 719(a)(1) which, unlike its successor, Section 439(b)(1), named mortgages as an acceptable evidence of indebtedness, but not conditional sales contracts):

> It is true, as pointed out by Consolidated, that in terms of liability imposed, there may be little, if any, distinction or difference between the legal relationship created by a mortgage and a conditional sales contract. Both instruments are intended to provide a measure of security for the performance of an incurred obligation, but they are not used synonymously or interchangeably to describe or define the legal relationship created thereby.

The court went on to say that this fact is especially significant where "it becomes necessary to discern the legislative intention". Thus, where, as here, a contract may, in a given instance be of substantially the same legal effect as a note, nevertheless, it is not a note since the two terms are not used "synonomously or interchangeably" and, when looking to the legislative intent, it must be recognized that the Congress chose to name one but omitted the other. In *Durr Drug Co.* v. *United States*, 99 F. 2d 757 (C.A. 5th), the court observed, in denying a claimed deduction, that the Congress might have provided in appropriate terms for coverage of the situation there at bar but that it had not. And, as the Supreme Court stated in *Deputy* v. *duPont*, 308 U.S. 488, 498, the plain, obvious and rational meaning of the statute

should not be sacrificed, even for the exigency of a hard case.

In *Frankel & Smith Beauty Departments, Inc.* v. *Commissioner*, 167 F. 2d 94 (C.A. 2d), the court had before it the contention that a contractual agreement constituted a note within the meaning of Section 719 (a)(1). In rejecting this argument on the ground that the sum agreed to be paid was not certain, the court observed that its opinion was based on this factor because the Commissioner had not contested the taxpayer's contention that it would otherwise have come within the term, but added that (p. 96):

> We have some doubt as to the correctness of taxpayer's basic contention that, for purposes of Sec. 719(a)(1), any unconditional written obligation, contained in a contract, to pay a sum certain is a "note"; * * *

The Supreme Judicial Court of Massachusetts has drawn a similar distinction in a case (*Burdett* v. *Walsh*, 235 Mass. 153, 126 N.E. 374) involving a contract which provided for the sale of real estate and stock and as to which all provisions had been performed except the payment of $3,000 of the purchase price which was to be accomplished by the issuance of a note in that amount, payable one year thereafter. The note was not issued and the question arose whether the intended payee could recover from a surety which had obligated itself in the event the sum due *under the note* was not paid. The court denied liability, saying (p. 155):

> The fact that the amount payable is precisely the same as if the note had been given cannot make the surety liable for the reason that the liability that it assumed and contracted to meet arose only in case [the debtor] failed to pay the sum due under the note provided for. *A note is not in legal effect the same as an ordinary contractual obligation to pay the amount named therein, even if unnegotiable.* (Emphasis added.)

In *Cobbs* v. *Commissioner*, 39 B.T.A. 642, the Board of Tax Appeals had before it a situation where the taxpayer had surrendered for its cash value a paid up life insurance and annuity policy as to which, apparently, nothing remained to be done except the payment by the insurance company of its evidenced cash obligation under the policy. The taxpayer claimed that the surrender transaction amounted to a "sale or exchange" of the policy under the provision of Section 117(f) of the 1939 Code, which provided that amounts received upon the "retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation * * * shall be considered as amounts received in exchange therefor." It was the taxpayer's position that the surrender of the insurance policy was essentially the same as the redemption of a bond and was covered, therefore, by the above language. The Board said (pp. 643-644):

> We think, however, that this presses logic too far. It would require a hypothesis that Congress, while using fairly clear language to change the law as to a specified list of securities,

> had intended to include also contracts which for one reason or another had been regarded as somewhat similar. This could easily have been done, if not by express specification in the statute, at least by an omnibus term broad enough to include insurance or annuity contracts. But no term in the paragraph is susceptible of such an interpretation. * * * Indeed, the clear specification of these compels the inference that insurance and annuity contracts were deliberately excluded.

In advancing the argument that the instant agreements must be treated as a "note" within the meaning of the statute, the taxpayer relies upon the decision of this Court in *Oregon-Washington Plywood Co.* v. *Commissioner*, 219 F. 2d 883, and upon *United States* v. *Ely & Walker Dry Goods Co.*, 201 F. 2d 584 (C.A. 8th), and *Strickland* v. *Holbrooke*, 75 Cal. 268, 17 Pac. 204. In each of those cases, the instruments involved were designated as notes and were instruments of the type normally known and referred to as notes. In each, the question was merely whether certain unusual features or sequence of language deprived them of that character. None involved an attempt to treat a contract for the sale of property as a "note". In *Oregon-Washington Plywood Co.* v. *Commissioner*, *supra*, the parties had executed the usual contractual instruments and, *in addition thereto*, there had been issued the usual form of promissory note *to evidence* the debt growing out of the contractual agreement. The issue there was thus entirely removed from that at bar. That this Court ruled, there, that reference might be had to the un-

derlying contracts to supply a certain lack of positive information in the note does not imply that the contract, itself, may be treated as a note in the absence of the latter.

The case of *United States* v. *Ely & Walker Dry Goods Co.*, *supra*, cited by the taxpayer (Br. 21), seems more to conflict with than to support its position. There, the Eighth Circuit, in holding that the instruments in question (a note given to a bank to evidence the taxpayer's obligation on a loan) was a "promissory note" within the meaning of the statutory provision there involved, distinguished several cases where instruments also designated as notes, and having all the elements thereof, were nevertheless held to be corporate securities, for which other provision was made in the statute, because having more of the characteristics of the latter. The court quoted (p. 588) from the Second Circuit's opinion in one of those cases (*General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593) the significant statement that "they [the instruments] were not *merely ordinary promissory notes* evidencing debts arising in the ordinary course of business". (Emphasis added.) Thus, while it is true that the inclusion in what is clearly a "note" of representations and provisions which are not normally elements thereof will not, alone, deprive it of that character, an instrument which goes beyond the elements of a "note", to the extent that it, in fact, conforms to the normal characteristics of another type of instrument which, in common usage and "acceptation", is described other-

wise than as a "note", will not be held to be a "note" within the meaning of a statutory provision incorporating that term and omitting the other. Here, the instruments in question are of the common variety known as a simple contract for the sale of property. There is no reason to believe that the Congress intended to include them within the scope of the specific term "note", by which term they are not usually described, nor should the statutory language be stretched to include them.

Brewster Shirt Corp. v. *Commissioner*, 159 F. 2d 227 (C.A. 2d), also relied upon by the taxpayer may have some tendency to support its position but is, we submit, of dubious authority, the court having reached its conclusion that the obligations involved there amount to "mortgages" within the meaning of the statute by an extremely loose construction of that term which is in conflict with the controlling rules of interpretation generally accepted and followed by the majority, *supra*. The nature of the decision in that case can best be demonstrated by the court's concluding statement that the factoring arrangements there at issue were "equivalent to" an indebtedness evidenced by a mortgage. This is precisely what the majority of authorities, *supra*, say is not sufficient to meet the express requirements laid down in the statute. Normal usage and acceptation does not describe a factoring arrangement as a "mortgage" and there is no reason to believe that the Congress so intended. It should also be noted that the Second Circuit distinguished the contrary holding of

several cases following the majority view only by stating as to each (p. 230) that "No mortgage was involved" and disregarding the underlying principles which produced the results in those cases and which were equally applicable to the term "mortgage" as used in the statute. Finally, the entirely different approach and results in *Frankel & Smith Beauty Departments, Inc.* v. *Commissioner, supra,* decided by the Second Circuit a year after its decision in *Brewster Shirt Corp.*, seem to represent an implicit overruling of the approach taken in the latter.

We do not attempt to distinguish *Aetna Oil Co.* v. *Glenn,* 53 F. Supp. 961 (W.D. Ky.), which, certainly seems to have held that a licensing contract for the use of gasoline cracking patents should be treated as a "note" within the provision of the statute there involved because the agreement contained all the elements required in a promissory note. Nevertheless, we believe that in that case, as in *Brewster Shirt Corp., supra,* the court reached an erroneous result by applying a broad, permissive construction of the language selected by the Congress, rather than requiring the instrument before it to come squarely within that language according to its ordinary usage and acceptation. The square conflict between the rules consistently announced in the previously discussed cases and the approach followed by the District Court in *Aetna Oil Co.* is sharply demonstrated by the language of the latter opinion where the court said (p. 966):

> The use in the statute of the several words "bond, note, debenture, certificate of indebted-

> ness, mortgage, or deed of trust" indicates that *no particular type of a written instrument was required* so long as the indebtedness was actually evidenced by a written instrument of some type containing the elements of an unconditional promise to pay. (Emphasis added.)

As stated heretofore, and as pointed out in the previously cited cases, had the Congress wished to cover *any* written instrument containing an unconditional promise to pay, it could have said so much more simply and in so many words. It is incredible to suggest that it intended to convey this meaning by a specific recitation of certain well known types of instruments, omitting others which, like contracts, also frequently reflect or give rise to such a promise or agreement but which are not customarily designated by any of the included terms.

Finally, we believe that the decision of the Tax Court in *Journal Publishing Co.* v. *Commissioner*, *supra*, contains rather ambiguous dicta with respect to the question whether any written contract which contains an *unconditional* promise to pay and meets the other requirements of a "note" should be treated as a "note" in applying the instant provision of the statute. True, it distinguished *Aetna Oil Co.*, *supra*, on the ground that, in the latter, there was nothing further to be done by the payee. But, the court did not there necessarily indicate the view that the decision in *Aetna* was correct but merely that its emphasis upon unconditionality confirmed the Tax Court's view that a conditional obligation cannot, in any event, constitute a note. Moreover, earlier in

the opinion (p. 524) the Tax Court had stated that the promise to pay contained in the agreement before it was merely "an element in a bilateral contract" and that payment of the sums called for were "conditioned on the performance by the News Co. of certain promises, namely, to deliver assets *and* to refrain from publishing or otherwise competing with petitioner". (Emphasis added.)

The obligations reflected in the modified agreements of December, 1950, are not eligible to be treated as "borrowed capital" within the meaning of Section 439 because they were, as shown in A, *supra*, terminable at the will of the taxpayer and because, as demonstrated above, they do not come within the statutory term "note" because they were so conditioned and because evidenced by instruments which in normal usage and acceptation are designated as contracts for the sale of property and not as "notes".

CONCLUSION

For the above reasons, the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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No. 18258

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

McCULLOUGH TOOL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING.

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PETITION FOR REHEARING.

To the Honorable Richard H. Chambers, Chief Judge, Stanley N. Barnes, Circuit Judge, Jesse W. Curtis, Jr., District Judge.

McCullough Tool Company, on the grounds hereafter stated, hereby petitions for a rehearing on the judgment entered June 11, 1963:

1. Petitioner, after a careful reading of the Opinion, believes this Court was under a misapprehension as to one crucial fact in the record. This misapprehension of fact was the belief that, under the terms of the license agreements as modified, petitioner's obligation to pay was conditioned upon the seller's performance. In actuality, the license agreements as modified, contain the two features described below which

make each agreement "an instrument which *by its terms purports to evidence* an unconditional promise to pay." Hence each agreement as modified is a "note" within the definition adopted by this Court in its Opinion filed herein:

A. The first feature is that under paragraph "1" the licensors "hereby grant" the patents to petitioner. This is not a promise to deliver a license agreement or an assignment at some future time. It is *in itself* a present, self-effecting, complete transfer of an interest. After signing the agreement, there was nothing further for the licensors to do. This is a crucial fact and the one with respect to which we believe this Court was under a misapprehension. Had this Court been aware that the license agreements as modified contained self-effecting assignments placing no further obligations on the licensors, we feel the Court would not have concluded as it did on the final page of its Opinion that "according to their terms, the obligation to pay was conditioned upon performance by the sellers."

B. The second feature is that in paragraph "6" as modified, the taxpayer "agrees" to pay a specified sum on a specified day of each month for a specified period of time.

2. Upon rehearing, petitioner desires to present argument directed to the following points as well as all other points which the Court may consider pertinent:

A. That a simple test showing petitioner's obligation to pay was not conditioned upon performance by the sellers is to ask how the licensors would have pleaded an action against petitioner for non-payment. Petitioner will submit that such a cause of action would be completely stated by merely pleading the execution of the agreements as modified, plus the fact of non-payment. Would the licensors have to plead the performance of any conditions? No. There are no such conditions.

B. That while prior to modification the license agreements might have imposed various obligations upon the licensors, any such obligations were eliminated by the modification agreements. Petitioner, immediately upon the signing of the agreements, automatically took all property rights to the patents which, together with all drawings, specifications, and claims, are matters of public record and therefore available to the public.

C. That the termination clause in the original agreement is inconsistent with the later modification agreement. Petitioner's right under the original agreements to give up the patents thereby avoiding future payments, which payments were to be computed on a "use" basis, was inconsistent

with petitioner's obligation under the modification agreements to pay fixed sums not measured by use. In this regard, petitioner urges that while sellers and petitioner *could* have agreed that the licensors must repurchase at petitioner's option, *they did not do so.* How much would licensors have to pay petitioner on such a repurchase? If the answer doesn't appear in the agreements, then the parties certainly did not agree upon a repurchase provision.

Respectfully submitted,

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HAROLD C. MORTON,
EDWARD S. RENWICK,

In Association With:
Wilson B. Copes,
Wellman P. Thayer,
James E. Harrington,
Attorneys for Petitioner.

Certificate.

Undersigned counsel certifies that this petition is not interposed for delay and that in his judgment it is well founded.

Dated: July 3, 1963.

EDWARD S. RENWICK,
One of the attorneys for Petitioner.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

EDWARD S. RENWICK,

No. 18258

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

McCULLOUGH TOOL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

CASES

STATUTES

No. 18258

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United States Court of Appeals

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PETITIONER'S REPLY BRIEF.

Summary of Argument.

I.

The obligation of the petitioner under the Modification Agreements was absolutely unconditional. No rights of termination in the petitioner survived the Modification Agreements since such rights of termination would be inconsistent with the specific undertaking of the petitioner in the Modification Agreements and since such Modification Agreements specifically provided that any provisions of the prior License Agreement which were inconsistent with the Modification Agreements should have no further effect. Further, it was the intention of the parties that the obligations of the petitioner be unconditional and the petitioner consistently treated them as such thereafter.

II.

The Modification Agreements constituted notes in accordance with every legally accepted definition of that term were notes within the meaning of Section 439(b)(1) of the 1939 Internal Revenue Code.

ARGUMENT.

I.

The Language and Intent of the Modification Agreements of December 28, 1950, Completely Abrogated and Nullified the Petitioner's Rights of Termination Found in the Prior License Agreements.

The respondent argues that certain rights of termination granted to the petitioner in the original License Agreements of January 1, 1944 and October 1, 1947 [Exs. B and D] prevented petitioner's obligations under the several Modification Agreements [Exs. C, E, F, G, H, I and J] from being unconditional and thereby in turn prevented the petitioner's obligations under the Modification Agreements from constituting an "outstanding indebtedness" and the Modification Agreements from being "notes". Since both are required to entitle the petitioner to include its obligations under the Modification Agreements in "borrowed capital" for excess profits tax purposes under Section 439(b)(1) of the 1939 Internal Revenue Code, the respondent concludes that the petitioner is not so entitled. The respondent is wrong.

The pertinent provisions of the Modification Agreements and the License Agreements are as follows:

1. The Modification Agreement [Ex. C] having reference to the Bullet patent License Agreement of January 1, 1944 [Ex. B] provides as follows with respect to petitioner's obligation to pay for the rights in the patents:

> "1. Paragraph 6 of said Agreement of January 1, 1944 is modified to read as follows:
>
> '6.
>
> 'In consideration of the rights in and to the patents and patent applications transferred, assigned

and sold by the Parties of the First Part (I. J. McCullough and O. J. McCullough) to the Party of the Second Part (petitioner), the Party of the Second Part (petitioner) hereby agrees to pay to the Parties of the First Part (I. J. McCullough and O. J. McCullough), in addition to all other payments heretofore made hereunder, $20,000.00 per month on the 28th day of each calendar month, commencing on the 28th day of December, 1950, for a period of six years and one month. The last of said monthly payments shall be due and payable on the 28th day of December, 1956. One-fourth of each of said monthly payments, or $5,000.00, shall be paid to O. J. McCULLOUGH, and three-fourths of said monthly payments, or $15,000.00, shall be paid to I. J. McCULLOUGH. The parties are agreed that the total of these payments, $1,460,000.00, shall be the full remaining price to be paid by the Party of the Second Part (petitioner) for the complete and absolute ownership of the patents and patent applications described in Exhibit "A".' "

2. The provision of the Bullet patent License Agreement of January 1, 1944 [Ex. B] providing for a right of termination in the licensee thereunder is as follows:

"7.

"The Licensee shall have the right to terminate this agreement upon first giving ninety day notice in writing to the Licensors to cancel and terminate this agreement together with all rights, licenses and obligations hereunder, provided, however, that no such termination or cancellation shall relieve the Licensee from the payment of any royalty due and payable to the Licensors at the time of such termination."

3. The Modification Agreements [Exs. E, F, G, H, I and J] having reference to the Jet patent License Agreement of October 1, 1947 [Ex. D] provide as follows (except as to parties and amounts) with respect to the petitioner's obligation to pay for the rights in the patents:

> "1. In lieu of the provisions for payment set forth in the said 'License Agreement' of October 1, 1947, by which the said inventions and patent applications were sold to the Corporation, insofar as they relate to 'I.J.M.' under the said assignment, the Corporation agrees to pay to 'I.J.M.' the sum of $717,500.00. Said amount shall be paid in equal monthly installments of $3,500.00, payable on the 28th day of each month, commencing on the 28th day of December, 1950 and ending with a payment on the 28th day of December, 1967."

4. The provision of the Jet patent License Agreement of October 1, 1947 [Ex. D] providing for a right of termination in the licensee thereunder is as follows:

> "XIV.
>
> "LICENSEE shall have the right to terminate this Agreement at any time upon the giving of sixty (60) days prior written notice thereof to LICENSORS: provided however, that in the event this Agreement is terminated in any manner provided in this Agreement before January 1, 1951, LICENSEE expressly covenants that it will not employ, or in any manner make use of, either directly or through any agent, subsidiary or affiliate, any of the information, data, or 'know-how' disclosed to LICENSEE by LICENSORS respecting the tools or methods embraced within the subject matter of this Agreement until after January 1, 1951."

5. The Modification Agreement of December 28, 1950 having reference to the License Agreement of January 1, 1944 [Ex. C] provides as follows:

> "2. It is agreed by the parties hereto that any and all provisions of said Agreement of January 1, 1944 which are *inconsistent with this Modification Agreement* shall have no effect. Said Agreement of January 1, 1944 has been considered by the parties thereto as an absolute assignment or sale of the subject matter thereof. That Agreement together with this Modification thereof shall be similarly construed hereafter." (Emphasis supplied.)

6. Each of the Modification Agreements having reference to the License Agreement of October 1, 1947 [Exs. E, F, G, H, I and J] provide as follows:

> "2. It is agreed by the parties hereto that any and all provisions of said Agreement of October 1, 1944 which are *inconsistent with this Modition Agreement* shall have no effect. Said Agreement of October 1, 1947 has been considered by the parties thereto as an absolute assignment or sale of the subject matter thereof. That Agreement together with this Modification thereof shall be similarly construed hereafter." (Emphasis supplied.)

As set forth above, paragraph 1 of each of the Modification Agreements contains a clearcut and completely unambiguous promise on the part of the petitioner to pay sums certain at determinable future times to the several individuals entitled thereto. Any right to terminate its obligation prior to the full payment of the sums specified in the Modification Agreements are absolutely inconsistent with the petitioner's undertaking to pay the specified sums provided for in

the Modification Agreements. Therefore, the language contained in paragraph 2 of the several Modification Agreements invalidating any language of the prior License Agreements which is inconsistent with the Modification Agreements absolutely and conclusively abrogated and nullified the previously existing rights of termination. The petitioner contends that the several agreements, when read together, cannot be otherwise construed.

Not only does the only possible construction of the several documents involved support the petitioner's contention that the rights of termination were made ineffective by the Modification Agreements, but such contention is also supported by all of the evidence with respect to the intention of the parties, both prior and subsequent to the execution of the Modification Agreements.

In testifying before the Tax Court, Mr. I. J. McCullough, the President of the petitioner stated as follows:

> "They (the several individuals entitled to royalties under the License Agreements of January 1, 1944 and October 1, 1947) stated that they had been advised that the Commissioner of Internal Revenue had revoked his order or regulation, whatever it was, whereby that the capital gains treatment of their royalty income would not be treated as such and therefore, they had been advised by their tax counsel that their best move or their best—his best judgment was they should offer the patents to the corporation to buy them outright for a fixed sum of money." [Tr. 16.]

The order or regulation to which Mr. I. J. McCullough was referring was Mimeograph 6490 1950-1

C. B. 9, wherein the Commissioner of Internal Revenue had withdrawn his acquiescence to *Edward C. Myers* (1946), 6 T. C. 258, and substituted therefor a nonacquiescence and in effect ruled administratively that after 1950 royalties received under a License Agreement which were measured by the use of patents and which were paid over a period which was coterminous with the life of the patent would be treated as ordinary income rather than capital gain. In effect what the parties intended was to preserve their capital gain status with respect to the payments received from the petitioner by selling their patents and inventions to the petitioner for a fixed sum rather than licensing them for a royalty based on use. It is submitted that the survival of a right of termination in the petitioner is inconsistent with such intention.

Further, the petitioner contends that its treatment of the obligations under the Modification Agreements subsequent to the execution thereof is inconsistent with the survival of any right of termination.

As the petitioner has pointed out in its opening brief, pages 17, 18 and 19, the petitioner, without exception, has consistently treated the Modification Agreements as imposing upon it fixed and unconditional obligations to make the payments set forth therein to the several individuals involved. Immediately after the execution of the Modification Agreements, the petitioner made entries on its books and records acknowledging to whomever it might concern its liability for the full amount of the purchase price of the patents which was payable under the Modification Agreements. Reference is again made to Exhibits L and M herein in which the petitioner in clear and unmistakable terms set up on its books and records its liability under the Modification Agreements. The

language used by the petitioner in acknowledging this liability is as follows:

> "To record liability for purchase of (Bullet and Jet) patents under Agreements of December 28, 1950" [Ex. L herein] and "Liability for purchase of patents". [Ex. M herein.]

On one occasion the petitioner made advance payments to one of the individuals entitled to payments under the Modification Agreements regarding the so-called Jet patents. Reference is again made to petitioner's Exhibit 5 herein, which evidences the advance payment to James M. Gray, one of the individuals entitled to payments under the Modification Agreements, of the amount of $19,950. This amount represented 60 monthly payments and it is inconceivable that petitioner would have made such advance payments to any creditor if it considered its liability therefor to be merely a terminable one.

Further, all of the payments called for by the Modification Agreements with respect to the Bullet patents were made by the petitioner to the individuals entitled thereto in strict conformity with the provisions of the Modification Agreements to the end that such agreements [Ex. 2 herein] were on December 28, 1956 completely executed. Also all of the payments set forth in the Modification Agreements with respect to the Jet patents have, from the date of execution of such agreements to the present time, been made by the petitioner in strict accordance with the terms of such Modification Agreements. There is not one iota of evidence in the record in this case that any of the parties at any time intended that the petitioner had any right whatsoever to terminate its obligation to make the payments set forth in the Modification Agreements to the several individuals entitled thereto.

The respondent's argument that such a right of termination survived the Modification Agreements flies in the face of not only the only reasonable interpretation of the language of the Modification Agreements, but also all of the evidence to the contrary and to very reason itself.

Further, it is clearly evident that the Tax Court, in ruling that the petitioner was entitled to take depreciation deductions after the execution of the Modification Agreements, was fully convinced that the petitioner was obligated to make the full amount of the payments set forth in the Modification Agreements. In its opinion the Tax Court states as follows:

> "What is material we think is that the Modification Agreements of 1950 substituted for petitioner's then existing obligation to make payments of royalties dependent upon gross receipts over the lives of the patents, new obligations to make payments of *sums certain* over specified shorter periods of time. Such substitution of obligations differing materially in extent and time are mutually supporting considerations giving rise to valid *and enforceable contracts.*" [R. 42.] (Emphasis supplied.)

and further:

> "No title was reserved by the transferors so far as we can see and petitioner *did not impose any conditions as to payment,* except to specify the time when they should be made." [R. 48.] (Emphasis supplied.)

The Tax Court's opinion that the petitioner was unconditionally obligated under the Modification Agreements to make payments of *sums certain* is completely and entirely inconsistent with the existence of any right

of termination. It cannot be said that the petitioner was obligated to make payments of *sums certain* if it had at any time prior to complete payment the right to terminate its obligation and make no further payments.

The respondent in its brief, page 19 thereof, misconstrues the basic contention of the petitioner. It is not the petitioner's contention that any right of termination is inconsistent with the sale of property. Contracting parties can, of course, agree upon a right of termination or a right in the buyer to require the seller to repurchase. What the petitioner does contend is that under the facts of this case any right of termination in the petitioner is inconsistent with the undertakings of the petitioner in the several Modification Agreements to pay fixed and certain sums of money to the several individuals involved, and that, therefore, the rights of termination provided for in the prior License Agreements are of no further effect because of the language in the Modification Agreements specifically so providing. The Oregon, California and Kansas cases which the respondent cites in support of its general rule of law which is not here involved are therefore inapposite to the issues involved in this case and need not be discussed by the petitioner.

II.

The Modification Agreements Constituted Notes Within Every Legally Acceptable Definition of That Term.

The respondent additionally contends that the written instruments here in question are not "notes". The respondent bottoms its arguments in this connection, first of all, on the fact that the rights of termination which respondent contends survived the Modification Agreements negative the element of unconditionality

and, therefore, prohibit the documents from being notes. The petitioner contends that it has clearly demonstrated that the so-called rights of termination did not survive but were nullified and abrogated by the Modification Agreements. In this connection the respondent, while admitting that the Tax Court held that the issue here presented was "apparently" controlled by the rule in *Journal Publishing Co. v. Commissioner,* 3 T. C. 518 (Resp. Br. p. 26) goes on, however, to state that the Tax Court in this case below "recognized" that the taxpayer's right to terminate the agreement and thereby to discharge itself from the obligation to make further monthly payments had the same effect in this case as did the taxpayer's duty not to compete in *Journal Publishing Co. v. Commissioner, supra.* (Resp. Br. p. 27.) There is absolutely nothing in the opinion of the Tax Court in this case which would justify such a statement by the respondent, and no such interpretation is possible. Indeed, the Tax Court in its opinion in this case completely fails to point out wherein the contracts here involved are in any way similar to the contract involved in *Journal Publishing Co. v. Commissioner, supra.* Indeed, it is the contention of the petitioner that herein lies the essence of the Tax Court's error. Had the Tax Court taken the trouble to compare the obligations of the petitioner under the Modification Agreements with the obligations of the taxpayer under the contract involved in *Journal Publishing Co.,* it would have seen the distinction and would not have been able to distinguish the case of *Aetna Oil Co. v. Glenn* (1944), 53 Fed. Supp. 961, as did the Tax Court in *Journal Publishing Co.* The Tax Court in *Journal Publishing Co.* did not hold that a contract could not also be a note. It held merely that the contract there in question was not a note. Indeed, it took great pains to do so and in distinguishing *Aetna Oil Co. v. Glenn,*

supra, it at least recognized the possibility that a contract could be a note, if not in fact impliedly so holding. The respondent's attempt to lead this Court to believe that the Tax Court below "recognized" that the petitioner after December 28, 1950 had any right of termination is indeed regrettable. As the petitioner has pointed out previously herein, the Tax Court in this case below found both that the Modification Agreements created new obligations to make payments of *sums certain* over specified shorter periods of time [R. 42], and that "no title was reserved by the transferor so far as we can see and petitioner *did not impose any conditions as to payments* except to specify the time when they should be made." [R. 48.] (Emphasis supplied.)

The second string to the respondent's argumentative bow in this respect is the general proposition that contracts cannot be "notes". Obviously, the respondent attempts to continue and compound the confusion caused by the Tax Court's opinion below.

At page 20 *et seq.* of its opening brief the petitioner sets forth several of the legally accepted definitions of a "note". Except for differences in wording, such definitions are as follows: "A written promise to pay a certain sum of money at a future time unconditionally." Except for its argument concerning rights of termination which are answered above, the respondent fails entirely to point out wherein the specific written instruments here involved do not meet every legally accepted definition of a note, nor does the respondent cite one case wherein its has been held that a written instrument, whether called a contract, agreement, or otherwise, which contains the essential elements of a note is not a note within the legally accepted definition of that term.

In *Consolidated Goldacres Co. v. Commissioner,* C. A. 10th (1948) 165 F. 2d 542, cited by the respondent, the Court was considering documents entitled "contracts of conditional sale". The Court after rather thoroughly reviewing the Tax Court's decision in *Journal Publishing Co. v. Commissioner, supra,* did exactly what the Tax Court did in *Journal Publishing Co.* — it determined that the contracts in question did not contain an unconditional promise to pay a certain sum of money at some future time. In its decision the Court pointed out that the Tax Court in *Journal Publishing Co.* had adopted the ordinary legal definition of the word "note" as "a written promise to pay a certain sum of money at a future time unconditionally." 165 F. 2d at 544. The Court also noted that the Tax Court in *Journal Publishing Co.* had recognized that a note need not be in any particular form. Then, after finding that the conditional sales contracts in question were bilateral in nature and that the obligation imposed upon the taxpayer therein was not unconditional and unilateral, stated as follows:

> "It is thus manifestly plain that the contract not having the attributes of an ordinary note cannot be so construed under Section 719(a)(1)." 165 F. 2d at 545.

It is submitted that the Court in *Consolidated Goldacres* was of the opinion that a written contract which does contain the essential elements of a note does meet the ordinary legal definition of a note and would therefore be a note. The Court in that case was not satisfied to say that a contract cannot be a note and to rest its decision on that basis.

Also in *Bernard Realty Co. v. United States,* C. A. 7th (1951) 188 F. 2d 861, cited by the respondent, the Court was not satisfied to rest its decision on the doc-

trine that a contract could not be a note but, on the contrary, found it necessary to find that a Wisconsin land contract was in effect bilateral and executory on both sides and that therefore the promise to pay contained therein was not unconditional.

The language quoted by the respondent from *Frankel and Smith Beauty Departments, Inc. v. Commissioner,* C. A. 7th (1948) 167 F. 2d 94 is pure dictum since the contention to which the Court was referring and which was propounded by the taxpayer was not contested by the Commissioner. However, here again the Court found it necessary to determine that the promise to pay contained in a lease was not unconditional and that, therefore, a note did not exist.

In both *Consolidated Goldacres Co. v. Commissioner, supra,* and *Bernard Realty Co. v. United States, supra,* the taxpayers were in effect arguing that the documents in question were in legal effect *equivalent to* the prescribed types of evidence of indebtedness contained in Section 719(a)(1) of the World War II Excess Profits Tax Law. The petitioner herein does not contend that the Modification Agreements are equivalent to notes—it contends that the Modification Agreements are notes within every legally accepted definition of that term.

The case of *United States v. Ely and Walker Dry Goods Co.,* C. A. 8th (1953) 201 F. 2d 584, was cited by the petitioner in support of its contention that promissory notes within the purview of the Revenue Acts can contain other provisions of substance and are not necessarily limited to some short form mercantile document. The Court in *United States v. Ely and Walker Dry Goods Co., supra,* does quote from the Second Circuit's opinion in *General Motors Acceptance Corp. v. Higgins,* 161 F. 2d 593, but in doing so is distinguishing it, and in so doing points out that in

substance thirty million dollars of long-term promissory notes issued to a few large investors who were in the market for the purchase of such securities for investment were held in the light of the transaction of which they were a part to be securities rather than promissory notes. The Court in *United States v. Ely and Walker Dry Goods Co., supra,* also states the well established rule that ". . . Taxation is concerned with substance and not with formalities. The substance of the transaction which a document or instrument evidences and not the label of the instrument controls."

Such was the effect of the decision in *Brewster Shirt Corporation v. Commissioner,* 159 F. 2d 227 (C. A. 2d), wherein the Court held that factoring agreements were "equivalent to" a mortgage. In commenting on the decision in the *Brewster Shirt Corporation v. Commissioner, supra,* case, the respondent suggests that it has been impliedly overruled by the decision in *Frankel and Smith Beauty Departments, Inc. v. Commissioner, supra.* Such is, of course, not the case. As pointed out above, the decision in *Frankel and Smith Beauty Departments, Inc. v. Commissioner, supra,* was merely to the effect that the lease there involved did not contain an unconditional promise to pay, and that such document could not therefore be considered a note. Nothing in the Court's opinion casts any doubt on *Brewster Shirt.*

The respondent readily admits that it cannot distinguish the case of *Aetna Oil Company v. Glenn, supra.* All the respondent does, as it attempts to do with respect to the case of *Brewster Shirt Corporation v. Commissioner, supra,* is to question its authority. In spite of its attempts to do so, the respondent fails entirely to make an inroads upon the well reasoned opinion of Judge Shackleford Miller, Jr., now a Judge of the Court

of Appeals for the Sixth Circuit. The *Aetna Oil Company v. Glenn, supra,* case stands squarely for the proposition that a written document, no matter what its label, which contains the essential elements of a note is a note.

In closing its brief, the respondent attempts to explain away the implied holding of *Journal Publishing Co. v. Commissioner, supra,* to the effect that a written contract which contains an unconditional promise to pay and meets the other requirements of a "note" should be treated as a note within the section involved in that case which was the precursor of the section involved in the instant case. The respondent attempts to do this by stating that the Tax Court in *Journal Publishing Co.* relies on *Aetna* to confirm the Tax Court's view that a conditional obligation cannot in any event constitute a note. The Tax Court did not need *Aetna* to do this—it had cited ample authority for such proposition earlier in its decision. The Tax Court in *Journal Publishing Co.* obviously found it necessary to distinguish the contract involved in *Journal Publishing Co.* from the contract involved in *Aetna* in order to avoid the holding of *Aetna,* which it in no way questioned at all.

Finally, the respondent's brief fails entirely to successfully meet the contentions of the petitioner (1) that the obligations of the petitioner, as evidenced by the Modification Agreements of December 28, 1950 constituted an "outstanding indebtedness," and were evidenced by "notes", as both of those terms are used in Section 439(b)(1) of the 1939 Internal Revenue Code. The petitioner's obligations under the Modification Agree-

ments are not rendered conditional by any rights of termination which were included in the prior License Agreements. Such rights were abrogated and nullified by the Modification Agreements. The Modification Agreements do constitute notes according to every legally accepted definition of that term. And none of the cases cited by the respondent contain a precedental holding to the effect that a written instrument which contains the essential elements of a note cannot be considered as a note for the purposes of the statute involved or any precursor statutes thereof. In fact, many of the cases cited, and the conclusion to be reached from the aggregate thereof, hold that a written contract can be and is a note if in fact it contains all of the essential elements thereof.

Conclusions.

For the reasons stated above and in the petitioner's opening brief, the decision of the Tax Court with respect to the issue involved herein is erroneous, should be reversed, and the case remanded to the Tax Court for a determination of the petitioner's correct income tax liability for the years here involved.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WILSON B. COPES

No. 18,263

IN THE

United States Court of Appeals

For the Ninth Circuit

STATE BOX COMPANY, a California Corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the Northern District of California, Northern Division

BRIEF FOR APPELLANT

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

Subject Index

Table of Authorities Cited

Cases

Statutes

Texts

No. 18,263

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BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from a Judgment entered on the 8th day of August, 1962 by the United States District Court for the Northern District of California, Northern Division, quieting the title of the United States to standing timber in Nevada County, California. (R. 91).

The District Court's jurisdiction was invoked under 28 U.S.C. 1345. (R. 1).

This Court's jurisdiction rests upon 28 U.S.C. 1291.

STATEMENT OF THE CASE

This is a suit brought by the United States to quiet title to timber now standing and to enjoin appellant from making any claim to the proceeds of a sale of timber already sold by the United States.

Pursuant to Section 3 of the Act of July 1, 1862, 12 Stat. 489, as amended by the Act of July 2, 1864, 13 Stat. 356, the United States granted every odd numbered section of land within twenty miles of the railroad to The Central Pacific Railroad Company of California. The Act excepted mineral lands from its operation, but as to mineral lands within 10 miles the timber thereon was granted to the railroad company. The land upon which the timber here involved is standing is located in Section 15, Township 18 North, Range 11 East. M.D.B. & M. (R. 79). This section is within ten miles of the railroad.

In the year 1925 this land was, for the first time, conclusively established to be mineral in character. (R. 80). As a result of this determination it became established that the original grant to the railroad company pertained only to the timber on Section 15 and fee title to the land, therefore, at all times remained in the United States. (R. 80).

Through mesne conveyances the timber on Section 15 passed from the railroad to appellant's predecessor, The Central Mill Company, a corporation (R. 81). The appellant, State Box Company, was the sole shareholder of The Central Mill Company, and upon its dissolution in 1944 appellant acquired all of its property. (R.82).

In November, 1954, the United States, acting through the Forest Service, sold a portion of the timber on Section 15 to Grizzly Creek Lumber Company. In 1955 some of this timber was cut on a selective basis and the United States was paid the sum of Eighty-six Thousand Two Hundred Fifty-four Dollars and Thirteen Cents ($86,254.13) by the purchaser. (R. 83).

Following the sale and cutting of some of the timber, the appellant instituted three lawsuits as follows:

(a) A suit against the purchasers for conversion of the timber. This action is pending in the Superior Court of the State of California in and for the County of Nevada. (R. 86).

(b) A suit against the United States to recover the value of the timber cut. This action is pending in the United States Court of Claims. (R. 86).

(c) A suit against the Secretary of Agriculture of the United States to quiet title to the timber remaining. This action is pending in the United States District Court for the District of Columbia. (R. 86).

After these three lawsuits were instituted, the Government filed this suit in the District Court to quiet its title to the remaining timber and to restrain the Appellant from asserting any claim concerning the timber removed in 1955. As the result of the Government's institution of this action, the three lawsuits previously mentioned have been held in abeyance.

In the District Court the appellant asked that its title to the timber on Section 15 be quieted and that

the Court declare that Appellant was the owner of the timber removed in 1955 and further that the Court award a money judgment for the value of the timber so removed.

On August 8, 1962 the District Court held that The Central Pacific Railroad Company and its successors were required to remove the timber within a reasonable time after 1862 and further that a reasonable time had elapsed and as a consequence all title to the timber had been lost prior to 1955. The District Court entered its Judgment quieting title in the United States and declaring that the United States was the owner of the timber which was removed in 1955, and the Court enjoined the appellant from asserting any interest in the remaining timber or in the proceeds of the 1954 sale against either the United States or its contract vendees.

SPECIFICATION OF ERRORS RELIED ON

1. The District Court erred in holding that the grantee of the timber was required to remove the timber within a reasonable time.

2. The District Court erred in holding that Appellant had forfeited its title by failing to remove the timber within a reasonable time.

3. The District Court erred in holding that the rights which attach to this grant of timber in 1862 are to be determined by reference to Federal Law rather than by reference to the law of the state in which the timber is growing.

4. The District Court erred in holding that Appellant is estopped to claim title to the timber.

QUESTIONS PRESENTED

1. Whether, under the Act of 1882, The Central Pacific Railroad Company acquired a perpetual estate in the timber.

2. Whether, assuming The Central Pacific Railroad Company did not acquire a perpetual estate in the timber, the failure to remove the timber within a reasonable time would cause a forfeiture of all rights in the timber.

3. Whether Federal Law rather than California Law governs the rights which attach to the grant of timber under the Pacific Railroad Act.

4. Whether the appellant is estopped to claim the timber.

SUMMARY OF ARGUMENT

This timber was granted by the United States to The Central Pacific Railroad Company in 1862 as a subsidy for the purpose of inducing private capital to construct a trans-continental railroad during wartime. All of the available historical evidence indicates that Congress intended to provide the railroad with a source of funds and credit and to grant a saleable commodity, to wit, a perpetual estate in all of the property granted.

The Congressional grant on its face was not subject to any limitations or conditions, and under these circumstances the grantee acquired a perpetual estate in the timber.

Even if the grant is construed as requiring removal of the timber within a reasonable time, in the absence of any evidence of an intention of Congress to the contrary, the legal effect to be given the failure to remove is to be determined by the settled law of California.

Under California law no forfeiture of title results from a failure to remove timber within a reasonable time. The Court will fix a time within which the timber owner may remove it and will by its Decree provide that upon a failure to remove within that time the landowner may himself remove the timber, sell it, and pay the net proceeds of sale to the timber owner. *Gibbs v. Peterson* (1912), 163 Cal. 758, 127 Pac. 62.

I. THE CONGRESSIONAL GRANT CONVEYED A PERPETUAL ESTATE IN THE TIMBER.

It is settled that a reservation or sale of timber may be so made as to pass to the purchaser or reserve to the grantor a perpetual right to have the timber remain on the land or a perpetual right to enter and remove it. 34 Am. Jur. 506. *Wilson Lumber Co. v. D. W. Alderman Sons Co.* (1908), 80 S. C. 106, 61 S. E. 217.

Where a deed is silent as to time of removal and no intention to sever is indicated by the terms of the contract, the situation of the parties, or the circum-

stances surrounding the execution of the contract, the grantee's rights are unaffected by failure to remove within a reasonable time. 34 Am. Jur. 507; *Hicks v. Phillips* (1912), 146 Ky. 305, 142 S.W. 394.

The question whether a deed of standing timber conveys a perpetual estate is fully annotated in 15 ALR 41, 31 ALR 944, 42 ALR 641, 71 ALR 143 and 164 ALR 423.

At the outset, the two most important considerations so far as the instant case is concerned are, first, that the Act of 1862 simply uses the word "grant" and makes no reference whatever to removal of the timber under any circumstances; and second that there is nothing indicated by the terms of the Act or by the situation of the parties or the circumstances surrounding the grant indicating that removal of the timber was contemplated.

The issue thus becomes more narrowly defined. If the conveyance uses the word "grant" and no others and there is no indication that the parties contemplated removal of the timber, what is the effect of the conveyance?

It is true that there are cases both ways; however, upon this narrow issue the majority of Courts actually hold that the grant creates a perpetual estate.

This is the rule in the following cases:

Wilson Lumber Co. v. D. W. Alderman Sons Co. (1908) 80 S.C. 106 S.E. 217; *Hicks v. Phillips* (1912) 146 Ky. 305, 142 S.W. 394; *Johnson v. King Lumber Co.* (1929) 39 Ga. App. 280, 147 S.E. 142; *Parks v.*

Anaconda Copper Mining Co. (1924) 69 Mont. 354, 222 Pac. 419; *Butterfield Lumber Co. v. Guy* (1908) 92 Miss. 361, 46 So. 78; *R. M. Gobban Realty Co. v. Donlan* (1915) 51 Mont. 58, 149 Pac. 484; *Lodwick Lumber Co. v. Taylor* (1906) 100 Texas 270, 98 S.W. 238; *Shenandoah Land and Anthracite Coal Co. v. Clark* (1906) 106 Va., 155 S.E. 561; *Bardon v. O'Brien* (1909) 140 Wis. 191, 120 N.W. 827; *Gabbard v. Sheffield* (1918) 179 Ky. 442, 200 S.W. 940; *Walters v. Sheffield* (1918) 75 Fla. 505, 78 So. 539; *Wait v. Baldwin* (1886) 60 Mich. 622, 27 N.W. 697; *Goodwin v. Hubbard* (1860) 47 Me. 596; *Crane v. Hoefling* (1942) 56 Cal. App. 2d 396, 132 Pac. 882; *Sears v. Ackermann.* (1903) 138 Cal. 583, 72 Pac. 171.

It is admittedly held in some cases that the timber must be removed within a reasonable time.

But in many of these cases the land is valuable for agricultural purposes, and the Courts rely upon this fact. Or in some cases the conveyance itself contains some reference to removal of the timber. Or there may be something in the circumstances of the parties indicating the parties contemplated removal. None of these factors applies to the Congressional Grant.

Clearly, the construction of the grant demands a determination of the intention of Congress when it said "the timber thereon is hereby granted to said Company." And it is Congress' intention in the year 1862 (not 1962) which is controlling.

The Supreme Court of the United States has spoken with reference to the bountiful Congressional policy

in *U. S. v. Union Pac. R. Co.* 91 U. S. 72, 79, 23 L. Ed. 224, 228:

> "Many of the provisions in the original act of 1862 are outside of the usual course of legislative action concerning grants to railroads, and cannot be properly construed without reference to the circumstances which existed when it was passed. The war of the rebellion was in progress; and, owing to complications with England, the country had become alarmed for the safety of our Pacific possessions . . . It is true, the threatened danger was happily averted; but wisdom pointed out the necessity of making suitable provision for the future. This could be done in no better way than by the construction of a railroad across the continent. Such a road would bind together the widely separated parts of our common country, and furnish a cheap and expeditious mode for the transportation of troops and supplies . . . Although this road was a military necessity, there were other reasons active at the time in producing an opinion for its completion besides the protection of an exposed frontier. There was a vast unpeopled territory lying between the Missouri and Sacramento Rivers which was practically worthless without the facilities afforded by a railroad for the transportation of persons and property. With its construction, the agricultural and mineral resources of this territory could be developed, settlements made where settlements were possible, and thereby the wealth and power of the United States largely increased; and there was also the pressing want, in time of peace even, of an improved and cheaper method for the transporta-

tion of the mails, and of supplies for the army and the Indians.

"It was in the presence of these facts that Congress undertook to deal with the subject of this railroad. The difficulties in the way of building it were great, and by many intelligent persons considered insurmountable."

Admitting that generally speaking grants by the United States must be construed favorably to the Government, nevertheless

"a general law offering grants and valuable privileges to corporations or individuals as an inducement to the construction of railroads or other works of a quasi-public character through a great, undeveloped public domain, should not be construed with the strictness of a merely private grant, but should receive a more liberal construction in favor of the purposes for which it was enacted."

73 C. J. S. 695;

U. S. v. Denver etc. R. Co. 150 U. S. 1, 15, 37 L. Ed. 970, 980.

Even if the grant were to be construed strictly, there is nothing in the language of the Congressional grant, or in the character of the land upon which this timber was situated, or in the Congressional journals of the time, or in the general historical circumstances, which would justify reading into the grant any intention upon the part of Congress that it should be limited in any way.

Congress was making an outright grant of public lands in perpetuity and also an outright grant of timber in perpetuity. The railroad was to be privileged to cut not only the timber it needed for construction purposes, but it was to receive as a reward for its enterprise thousands of acres of land which it could patent and sell to settlers, thus building up a profitable Western empire. The timber on those lands, where it existed, would be of vital importance to the railroad for sale in the future development of the communities of the West. To say that Congress intended that the railroad must clear the timber from the mineral lands within ten years or twenty years or fifty years or one hundred years would be to contradict the very purposes of the grant.

Equally important with legal precedents, perhaps more so, are some factual and historical considerations which bear upon the intention of Congress in 1862:

1. There is a striking and important difference between the Pacific Railroad Act and subsequent railroad acts with respect to excluded mineral lands. The Act of July 2, 1864, 13 Stat. 365 Section 3, enacted the same day as the amendment to the Pacific Railroad Act and which granted lands to the Northern Pacific Railway Co., and the Act of 1866, 14 Stat. 292, (Section 3) exclude mineral lands from the grant but provide that in lieu thereof "a like quantity of unoccupied and unappropriated agricultural land" is granted. There is no such provision in the Pacific Railroad Act. Instead of "in lieu" agricultural land, the railroad is granted the timber on the excluded

mineral land. The conclusion is inescapable that the 38th Congress intended to grant a perpetual fee interest in the timber.

2. The "mineral lands" were of potential value for only two purposes, either the extraction of minerals, or the timber itself. This timber has been described as "hardly excelled in the North American continent"[1] and as "some of it being the finest timber in the state."[2] Immediately following the construction of the railroad, although agricultural land was offered for sale at $2.50 per acre and oak wood land at $5.00 per acre, the pine timber land was priced at $10.00 per acre.[3]

3. The Act itself is most revealing. The government argued in this case that the congressional grant conveyed only such timber as might reasonably be required by the railroad for the purpose of building the road itself. Portions of the memorandum of the District Judge (R. 55) indicated that the Court was persuaded by this argument. Section 2 of the Act gives to the Railroad a right of way and also the right to take earth, stone, timber and other materials from adjacent public land for the purpose of constructing the railroad. Section 3, of course, granting the timber on the mineral lands would be superfluous if it was to grant only the right to take such timber as would be

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[1]Railroad Pamphlets, Volume 4, Pamphlet No. 15, California State Library.

[2]Clark, Leland Stanford, page 200.

[3]Railroad Pamphlets, supra.

required for building the road. This argument is also negated by the fact that the railroad sold thousands of acres of the timber to private parties without any objection from the government.

4. It must also be remembered that the Act was interpreted to provide for an administrative determination of the mineral character of the land (*Burke v. S. P. R.R.* 234 U. S. 669, 58 L. Ed. 1527) and with respect to Section 15, the mineral character of the land was not established until 1925, 63 years after the grant. Under these circumstances it is not realistic to attribute to Congress an intention that the timber on Section 15 be removed within a reasonable time after 1862.

5. Finally, the actual numerical majority of cases which had been decided at this date held that a grant of timber was to be construed as creating a perpetual estate.

The key to the intention of Congress in granting the timber is really found in its exception of the mineral lands. The only logical assumption which can be made is that Congress, in excepting the mineral lands from the grant, did so to reserve the same for locators of mineral claims. Sec. 4 of the Act of 1864 fortifies this assumption. It provides that the grant shall not include any timber necessary to support the improvements made by a miner but it does not disturb the primary grant. Inasmuch as the purposes of these locators in extracting minerals could be served just as well whether the owner of the timber removed it or

left it standing, there is no reason to suppose Congress intended to reserve any interest in the timber for the benefit of mineral claimants, other than that provided for by Sec. 4. Congress' policy in excepting the mineral lands would not in any way be interfered with by construing the grant as it reads, namely, an outright grant. Permitting the timber to remain upon the land would have no effect whatever upon its use for mineral exploration.

Research has disclosed only one case construing a separation of the timber from the land where the land was to be used for mineral purposes. In *Shenandoah Land and Anthracite Coal Co. v. Clark* (1960) 106 Va. 100, 55 S. E. 561, a conveyance reserved the timber on rough and mountainous land which was acquired by the grantee for the purpose of exploring for minerals. The Court held that the reservation of the timber was a perpetual one and the timber owner was not required to remove the timber within a reasonable time.

Once again, so far as research discloses, the Congressional grant of 1862, as it concerns the timber, has been construed in only one reported case. *Carr v. The Central Pacific Railroad,* (1880) 55 Cal. 192, held that the railroad had good title to the timber as against the claims of a subsequent mineral patentee. In that case the Court says:

> "The words of the grant are very broad. We all think this Judgment will have to be affirmed. The language seems to be about as broad as it can be: That 'The timber thereon is hereby granted'."

We have always felt that no lawyer, searching for the means with which to convey a perpetual estate in timber could come upon a stronger word than "grant".

We believe Mr. Justice Frankfurter describes the situation precisely in his dissenting opinion in *United States v. Union Pacific Railroad Company,* 353 U. S. 112, 137 1 L. Ed. 2d 224, 228:

> "The Court cannot in 1957 retrieve what Congress granted in 1862. The hindsight that reveals the act as lavish or even profligate ought not to influence the Court to narrow the scope of the 1862 grant by reading it in the light of a policy that did not mature until half a century thereafter. As the Court said in a very early construction of the act before us: 'No argument can be drawn from the wisdom that comes after the fact.'"

II. FAILURE TO REMOVE WITHIN A REASONABLE TIME DOES NOT RESULT IN A FORFEITURE OF TITLE.

The question involved upon this appeal has been previously litigated. In 1949 an action was instituted in the United States District Court for the Northern District of California, Northern Division, entitled *United States v. Waldron,* No. 6105, in which the United States sought to quiet its title to timber located in Section 21, which is located but a short distance from Section 15 and from the standpoint of the source of title, namely, the Act of Congress of 1862,

is identical with the timber involved in this case. The District Court in this case took judicial notice of the *Waldron* decision. (R. 85).

There is set forth in Appendix "A" of this Brief a copy of those portions of the record in the *Waldron* case which express the findings and judgment of the Court in that action.

This record reveals that then United States District Judge Dal M. Lemmon relied upon the rule in the case of *Gibbs v. Peterson,* (1912) 163 Cal. 758, 127 Pac. 62, in his original order. In his Interlocutory Decree Judge Lemmon allowed the defendants a period of approximately one additional year within which to remove the timber, decreed that if the defendants did not remove it within that time the United States was authorized to remove and sell it at the expense of and for the benefit of the defendants, and account to the defendants for the net proceeds. Judge Lemmon's decree further provided that if the timber was not removed within the specified period the United States would then be entitled to retain from the proceeds of the ultimate sale of the timber such amount as would reasonably compensate it for the use and occupancy of the land from the date of the expiration of the specified period up until the time of the actual removal of the timber.

Thereafter the parties stipulated to the making and entering of an amended interlocutory decree giving to the defendant approximately two years within which to remove the timber but limiting them to timber at least 22 inches in diameter (which was found

to be the size of timber which had been growing upon the land in 1862).

The law applied in the *Waldron* case is the settled law of California as indicated by Judge Lemmon. This general rule has been consistently followed in such later cases as: *Anderson v. Palladine* (1918) 39 Cal. App. 256, 178 Pac. 553; *Crane v. Hoefling* (1942) 56 Cal. App. 2d 396, 132 Pac. 2d 882.

Furthermore, as these cases hold, even when the grant shows that the parties contemplated that the timber should be removed within some specific time, the rule in California is that a forfeiture will not result from a failure to remove the timber. The California rule is an equitable one, avoiding a forfeiture and protecting the rights of all parties.

III. THE COURT SHOULD BE GUIDED BY CALIFORNIA LAW.

The District Court held the construction of the Congressional grant ". . . is a Federal not a State question." (R. 54). Although recognizing that the settled law of California would if applied to this case, prevent a forfeiture of appellant's title (R.60), the Court refused to apply California law.

By reason of the sanctity accorded real property titles, the usual rule resolves questions as to the legal effect of a grant by the law of the State in which the real property is situated. Any departure from this rule has the effect of rendering uncertain long established titles to real property.

Timber is no different than any other real property. With respect to the identical question involved in this case, namely, the legal effect of a failure to remove timber, the Federal Courts follow the rule of law of the state where the timber exists. *Thomas v. Gates,* (C.C.A. 4, 1929), 31 Fed. 2d 828 (Cert. denied October 14, 1929, 280 U. S. 259).

The District Court, however, held that a Federal grant of timber stands upon a different plane.

We acknowledge the existence of the rule to the effect that whenever the question in any Court, State or Federal, is whether a title which was once the property of the United States has passed, that question must be solved by the laws of the United States. *United States v. Oregon,* 295 U. S. 1, 79 L. Ed. 1267.

However, we contend that rule does not apply where the United States has admittedly parted with title and has made an outright grant of specific real property.

> "Federal law controls in the disposition of land of the United States and the question whether title to land has passed from the United States must be determined by Federal law . . . But lands, title to which has passed from the United States, in general stand as any other property within the State."
>
> 73 C.J.S. 67;
>
> *State v. Baschelder,* 5 Minn. 223, 80 Am. D. 410.

In *United States v. Oregon,* 295 U. S. 1, 79 L. Ed. 1267, the specific question is whether lands located

between the high and low water marks, and adjoining uplands granted by the United States could be declared by a State Legislature to belong to the State, and approaching this question the Court acknowledges the rule for which we contend when it says at page 28:

> "In construing a conveyance by the United States of land within a state the settled and reasonable rule of construction of the state affords an obvious guide in determining what impliedly passes to the grantee as an incident to land expressly granted. But no such question is presented here, for there is no basis for implying any intention to convey title to the State.
>
> The State in making its present contention does not claim as a grantee designated or named in any grant of the United States."

The Act of 1862 constituted a grant in praesenti, did not require the issuance of a patent, and accomplished a complete divesting of the title of the United States. *Missouri Valley Land Co. v. Wiese,* 208 U. S. 234, 2 L. Ed. 466; *Deseret Salt Co. v. Tarpe,* 142 U.S. 242, 35 L. Ed. 999.

The basic rule was expressed in *Hardin v. Jordan,* 140 U. S. 371, 35 L. Ed. 428, where the Court says:

> "In our judgment the grants of the Government for lands bounded on streams and other waters without any reservation or restriction of terms are to be construed as to their effect according to the law of the State in which the lands lie."

And in *United States v. Oklahoma Gas and Electric* Co., 318 U. S. 206, 87 L. Ed. 716, the rule is stated:

> "A conveyance by the United States of lands which it owns beneficially . . . is to be construed in the absence of any contrary indication according to the law of the state where the land lies."

The same principle is applied in *U. S. v. Illinois Central R. R.,* 154 U. S. 225, 38 L. Ed. 971.

A grant of California land to the United States is to be construed by California law. *Los Angeles and Salt Lake R. Co. v. U. S.,* 140 Fed. 2d 436, cert. denied 32 U. S. 757, 88 L. Ed. 1586.

In *Reconstruction Finance Corporation v. Beaver County,* 328 U. S. 204, 90 L. Ed. 1172, the Court says at page 210:

> "We think the Congressional purpose can best be accomplished by application of settled state rules as to what 'constitutes real property' *so long as it is plain as it is here that the State rules do not effect a discrimination against the Government* or patently run counter to the terms of the Act" (Italics supplied)

We are not unmindful of the doctrine expressed in such cases as *Clearfield Trust Co. v. United States,* 318 U. S. 363, 87 L. Ed. 838, to the effect that the application of State law is denied where it would make identical transactions subject to different laws of different states. That principle has not been and should not be applied to destroy recognized titles to real property.

The proper rule is that if the United States has admittedly granted property, and Congress has mani-

fested no intention that the grant is to be construed other than by State law and the State law does not effect a discrimination against the government, then the rights which attach to the grant should be determined by reference to State law as a guide.

There is no evidence existent that Congress in 1862 intended the application of any law other than the law of California.

The Pacific Railway was constructed in Nebraska, Wyoming, Utah, Nevada and California.[4] Of these, California alone was a state in the year 1862. In fact, Congress expressed some concern over the policy involved in granting land in one state only for the purpose of construction of a trans-continental railroad.

Typical of this view is the statement of Pugh of Ohio in a speech in support of an amendment which he offered to the pending bill to the effect that its provisions should apply to a road to the Eastern boundary of California instead of to San Francisco:

> "I do not think the Government of the United States can justify itself for building a railroad in a state. It was very good Democratic doctrine in the days of Jackson and Madison that we could not do so. I am willing to aid in building this road through the territories, but I will no more vote to build it in the State of California than I will in the State of Missouri."[5]

Under the circumstances there is no persuasive evidence that Congress intended that any law other than

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[4]Sabin, Building the Pacific Railway.

[5]Globe, 35th Congress, Second Session, page 420.

the law of California should be applicable to this grant.

IV. THE DOCTRINE OF ESTOPPEL IS NOT APPLICABLE.

The complaint alleges the defendant is estopped to assert any ownership in the timber in view of its "failure to assert title at any time prior to 1958 and because it permitted the sale of the timber without objection, to the detriment of the government." (R. 3).

The District Court concluded (R. 87) that appellant was estopped by reason of

> "its failure and the failure of its predecessors in title to claim ownership of or to assert any interest in the timber for at least 30 years prior to 1958, during which time the plaintiff administered the property as its own and twice included the timber in timber sales."

The doctrine of estoppel cannot be applied to defeat a vested title to real property. The owner of real property loses his title only by grant or by adverse possession.

> "As to real property, the general rule is that where the state has passed a perfect legal title, the doctrine of abandonment is not applicable thereto and that the title vested in the grantee cannot be affected or transferred by his act in departing from the dominion over it."
>
> 1 Am. Jur. 5.

> "Clearly, inaction or indifference of a fee owner will not divest his title. Disclaimer of freehold can only be by deed or in Court of record.

> One cannot divest himself of title to land by mere declaration that he does not own or claim any of it, and a vested title to land cannot be lost by oral admission that it is the land of another."
>
> 73 C.J.S. page 208.

In *East Tennessee Iron and Coal Co. v. Wiggin,* 68 Fed. 446, 449, the Court states the principle:

> "Precisely what is meant by an abandoned legal title is hard to define. If it is a valid legal title, it is inconceivable how it can be abandoned . . . McCoy's (the grantee's) disappearance and long neglect to assert the title which appellants claim he acquired by his adverse possession did not operate to extinguish or toll it; nothing but a possession adverse to him would have such a consequence. Plaintiffs did not abandon their title by neglecting for forty years to take possession or bring action."

The facts themselves do not warrant the conclusion that appellant is estopped. The District Court relied upon the following facts:

1. The failure of appellant and its predecessors to "assert any interest" in the timber.

2. The administration of Section 15 by the Forest Service.

3. An attempt, by the government, in 1937 to sell the timber. (R. 83).

4. The 1954 sale of the timber.

The failure of appellant and its predecessors to assert any interest in the timber is not persuasive. An

owner of real property is not required to affirmatively assert any interest in order to maintain his title.

The administration of Section 15 by the Forest Service is not a hostile act which is adverse to appellant's ownership of the timber. The United States has, ever since 1925, when the mineral character of Section 15 was conclusively established, been the acknowledged owner of the surface and it therefore would be expected to administer the property as its own. The Forest Service administered Section 23 (the Waldon timber) in the same fashion as it administered Section 15.

The 1937 attempt to sell the Section 15 timber is not in any way adverse to appellant's title. As revealed by the District Court's Finding Number 12 (R. 83) the sale was made to a stranger to the title and there is absolutely no evidence other than the publication of one general notice in a Nevada County newspaper that this attempt to sell was ever communicated in any manner to appellant's predecessor in title despite the fact that the identity of the timber owner was at all times ascertainable from the public records.[6] Once again, the 1937 sale also covered the Waldron timber and was not found to be persuasive in the *Waldron* case.

With respect to the 1954 sale appellant learned of the sale and commenced to actively assert its title to

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[6]The Supreme Court has recently held that this kind of notice does not measure up to due process requirements. *Schroeder v. New York*, decided Dec. 17, 1962. 9 L. Ed. 255.

the timber before the expiration of the period of time which would deprive appellant of its title by adverse possession.

Further, of course, inherent in the District Court's imposition of an estoppel is an implied finding that the United States relied in some manner to its detriment upon the inaction of appellant. It is painfully apparent there was no such reliance. Ever since the acquisition of title by The Central Pacific Railroad, the ownership of the timber by the railroad and its successors has been readily apparent from an examination of the official records of the County Recorder of Nevada County. Notwithstanding this fact, the government has never demanded of the record owner that the timber be removed nor has it ever given any notice to the record owner of its intention to sell. Furthermore, following the decision in *United States v. Waldron,* the government permitted State Box Company and other owners of timber with identical title history to cut and remove it. (R. 35, 86). But, although after the *Waldron* decision State Box Company apparently would have been permitted to cut and remove the timber on Section 15 had it requested permission (R. Vol. II 35), since in ignorance of its ownership it failed to request such permission, it was thereby completely divested of its title. This is indeed a strange application of the doctrine of estoppel.

CONCLUSION

For the reasons stated, it is respectfully submitted that the District Court's order be reversed and the cause remanded with instructions to enter an order declaring that appellant was the owner of the timber removed and is the owner of the timber now standing on Section 15.

Dated, Sacramento, California,
February 1, 1963.

HAROLD T. KING,
Attorney for Appellant.

I certify that, in connection with preparation of this brief, I have examined rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion the foregoing brief is in full compliance with those rules.

HAROLD T. KING,
Attorney for Appellant.

(Appendix Follows)

Appendix.

Appendix

In the United States District Court
for the Northern District of
California, Northern Division

No. 6105

United States of America
Plaintiff,

vs.

P. S. Waldron, Margaret A. Waldron, State Box Company, a corporation, and Tahoe Sugar Pine Company, a corporation,
Defendants.

ORDER

I will find that the defendants P. S. Waldron and Margaret A. Waldron are the successors in interest to the Central Pacific Railroad Co. and the owners of the timber in question, subject to the rights of the State Box Company as to which as between the defendants there is no dispute; that as between the parties to this action the plaintiff is the owner of the fee of the land upon which the timber stands, subject to the right of the Waldrons to remove the timber.

The rule in the case of Gibbs v. Peterson, 163 Cal. 758, will be applied. Defendants shall have until November 1, 1950 within which to remove the timber and, if they do not remove the same within that time, plaintiff may remove and sell the same at the expense and for the benefit of the defendants, accounting to the defendants for the net proceeds thereof; if the timber be not removed within that period, plaintiff will be entitled to retain from the proceeds of the sale of the timber such amount as will reasonably compensate plaintiff for the loss of use and occupancy of the land for the period following November 1, 1950 to the time of the actual removal, such amount to be determined by the court. An interlocutory decree will be entered accordingly. Findings of fact to be prepared by the defendants.

Dated October 26, 1949.

Dal M. Lemmon
United States District Judge

Endorsed: Filed Oct. 26, 1949.
C. W. Calbreath, Clerk.

[Title of Court and Cause]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on for trial before the court without a jury on May 5th, 1949, Emmet J. Seawell, appearing for plaintiff and Messrs. Edward D. Landels, Sumner Mering and Robert M. Searls appearing for defendants. Both oral and documentary evidence was received and the cause submitted for decision. The court herewith makes the following findings of fact and conclusions of law:

Findings of Fact

The court hereby finds as follows:

I.

That by the Act of Congress of July 1st, 1862, United States of America granted to the Central Pacific Railroad Company all of the timber located upon the lands described in the complaint herein; that defendants P. S. Waldron and Margaret A. Waldron acquired all of the title and interest of the Central Pacific Railroad Company in and to said timber and in 1945 entered into a contract of sale of said timber with defendant State Box Company, a corporation.

II.

That it is not true that defendants or their predessors in interest failed to cut and remove the timber on the lands described in the complaint within a reasonable time after the grant thereof by plaintiff.

III.

That it is not true that defendants or their predessors in interest failed to cut and remove the timber on the lands described in the complaint within a reasonable time after they had reason to believe that said lands were mineral in character.

IV.

That at no time prior to the year when defendants began to cut the timber on said lands was it commercially feasible to cut and remove the same.

V.

That prior to the time when the new road was built between Highway 20 and the Town of Washington in 1944, the timber on said lands could not have been cut and delivered to the market and sold for a price sufficient to cover the cost of felling, hauling and milling the same.

VI.

That it is true that the defendants did begin to cut said timber within a reasonable time and continued cutting until ordered by plaintiff to desist.

VII.

That until November 1st, 1950, is a reasonable time within which to allow defendants to cut and remove said timber.

Conclusions of Law

As Conclusions of Law from the foregoing facts the court finds:

I.

That as between the parties hereto, defendants P. S. Waldron and Margaret A. Waldron are the owners of the timber located upon the property described in the complaint herein, subject to the rights of defendant, State Box Company, under a contract of purchase between said defendants P. S. Waldron and Margaret A. Waldron and said defendant State Box Company.

II.

That as between the parties hereto, plaintiff United States of America is the owner of the fee title to the lands described in the complaint herein, subject to the rights of defendants to remove the timber located thereon.

III.

That if defendants fail to remove said timber within a reasonable time, which is hereby fixed by the court as some time before November 1st, 1950, plaintiff has the right and is entitled to cut and remove the timber and sell the same at the expense and for the benefit of defendants, accounting to the defendants for the net proceeds thereof.

IV.

That if defendants fail to remove the timber from said lands within the time hereby fixed by the court plaintiff will be entitled to retain from the proceeds of the sale of the timber such amount as will reasonably compensate plaintiff for the use and occupancy of said lands for the period following the period

from November 1st, 1950 to the time of the actual removal of said timber.

V.

An interlocutory decree is hereby ordered to be entered in accordance herewith.

Dated: ————————, 1949.

Dal M. Lemmon
United States District Judge

[Title of Court and Cause]

INTERLOCUTORY DECREE

This cause having come on regularly for trial without a jury and this court having this day made its Findings of Fact and Conclusions of Law, it is hereby ordered, adjudged and decreed as follows:

That defendants P. S. Waldron and Margaret A. Waldron are the successors in interest of the Central Pacific Railroad Company and are the owners of timber on the following described lands:

> Lots 12, 14 and 15 and the NW¼ of the NE¼ of Section 21, Township 18 N., Range 11 E., M.D.B. &M. in Nevada County, California

subject to the rights of defendant State Box Company under a contract of purchase entered into between it and said defendants, P. S. Waldron and Margaret A. Waldron; and that the United States of America, as between the parties to this action, is the owner of the fee title to said lands subject to the right of the defendants to remove the timber standing thereon.

That defendants are allowed until November 1st, 1950 within which to remove the timber located upon the above described lands and that if they do not remove the same within said time, plaintiff United States of America is authorized to remove and sell the same at the expense of and for the benefit of defendants, accounting to the defendants for the net proceeds thereof and if said timber is not removed within the period herein provided, plaintiff United States of America is entitled to retain from the pro-

ceeds of the sale of said timber, such amount as will reasonable compensate it for the loss of use and occupancy of said land for the period between November 1st, 1950 to the time of the actual removal of said timber, such amount to be hereafter determined by the court in appropriate proceedings, reserving to the court the power to extend the time allowed for the removal of the timber should defendants be prevented from removing the same by an order staying the judgment pending an appeal.

Dated: November 21st, 1949.

Dal M. Lemmon
United States District Judge

Approved as to form:
Emmet J. Seawell
Attorney for Plaintiff

Endorsed: Filed Nov. 21, 1949.
C. W. Calbreath, Clerk.

[Title of Court and Cause]

AMENDED ORDER

I will find that the defendants P. S. Waldron and Margaret A. Waldron are the successors in interest to the Central Pacific Railroad Co. and the owners of the timber in question, subject to the rights of the State Box Company as to which as between the defendants there is no dispute; that as between the parties to this action the plaintiff is the owner of the fee of the land upon which the timber stands, subject to the right of the Waldrons to remove the timber.

The defendants shall have until November 1, 1951 to exercise their right to remove that timber which was growing on the land in question at the time of the grant and on which cutting rights have not been exercised. An interlocutory decree will be entered accordingly. Findings of fact to be prepared by the defendants.

Dated, January 20, 1950.

Dal M. Lemmon
United States District Judge

[Title of Court and Cause]

STIPULATIONS

It is stipulated by the parties hereto that upon motion duly made by the plaintiff, an Amended Findings of Fact, Conclusions of Law, Order, and an Interlocutory Decree, may be made and entered by the court wherein timber is defined and the rights of the parties are more specifically determined.

Plaintiff hereby agrees and stipulates that in consideration of the above it will not appeal from the Amended Interlocutory Decree entered herein provided that if the said Amended Findings of Fact, Conclusions of Law, Order, and Interlocutory Decree are not made by the court, this stipulation will not be binding upon the parties herein.

Dated this 20th day of January, 1950.

Sumner Mering
Edward Landels
Robert Searls
Attorneys for Defendants

Assistant U. S. Attorney
Emmet J. Seawell
Attorney for Plaintiff

[Title of Court and Cause]

AMENDED FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on for trial before the court without a jury on May 5, 1949, Emmet J. Seawell, appearing for plaintiff and Messrs. Edward D. Landels, Sumner Mering and Robert W. Searls appearing for defendants. Both oral and documentary evidence was received and the cause submitted for decision. An order was made by the court and an interlocutory decree entered. Subsequently a motion was duly made to open, modify and clarify such interlocutory decree. The court herewith makes the following amended findings of fact and conclusions of law:

Findings of Fact

The court hereby finds as follows:

I

That by the Act of Congress of July 1, 1862, United States of America granted to the Central Pacific Railroad Company all of the timber located upon the lands described in the complaint herein; that defendants P. S. Waldron, Margaret A. Waldron acquired all of the title and interest of the Central Pacific Railroad Company in and to said timber and in 1945 entered into a contract of sale of said timber with defendant State Box Company, a corporation.

II

That the timber subject to this decree is all that timber which was growing on the land in question at the time of the grant and on which cutting rights

have not been exercised, which is determined to be all timber of 22 inches or more largest measure diameter breast high.

III

That it is not true that defendants or their predecessors in interest failed to cut and remove the timber on the lands described in the complaint within a reasonable time after the grant thereof by plaintiff.

IV

That it is not true that defendants or their predecessors in interest failed to cut and remove the timber on the lands described in the complaint within a reasonable time after they had reason to believe that said lands were mineral in character.

V

That at no time prior to the year when defendants began to cut the timber on said lands was it commercially feasible to cut and remove the same.

VI

That prior to the time when the new road was built between Highway 20 and the Town of Washington in 1944, the timber on said lands could not have been cut and delivered to the market and sold for a price sufficient to cover the cost of felling, hauling and milling the same.

VII

That it is true that the defendants did begin to cut said timber within a reasonable time and continued cutting until ordered by plaintiff to desist.

VIII

That until November 1, 1951, is a reasonable time within which to allow defendants to cut and remove said timber.

Conclusions of Law

As Conclusions of Law from the foregoing facts the court finds:

I

That as between the parties hereto, defendants P. S. Waldron and Margaret A. Waldron are the owners of the timber as defined in the complaint herein, subject to the rights of defendant, State Box Company, under a contract of purchase between said defendants P. S. Waldron and Margaret A. Waldron and said defendant State Box Company.

II

That as between the parties hereto, plaintiff United States of America is the owner of the fee title to the lands described in the complaint herein, subject to the rights of defendants to remove the said timber located thereon.

III

That the defendant shall have as a reasonable time until November 1, 1951 to exercise their right to remove the said timber.

IV

An interlocutory decree is hereby ordered to be entered in accordance herewith.

Dated this 20th day of January, 1950.

Dal M. Lemmon
United States District Judge

[Title of Court and Cause]

AMENDED INTERLOCUTORY DECREE

This cause having come on regularly for trial without a jury and this court having this day made its Amended Findings of Fact and Conclusions of Law, it is hereby ordered, adjudged and decreed as follows:

That defendants P. S. Waldron and Margaret A. Waldron are the successors in interest of the Central Pacific Railroad Company and are the owners of the timber on the following described lands:

> Lots 12, 14 and 15 and the NW¼ of the NE¼ of Section 21, Township 18 N., Range 11 E., M.D.B.&M. in Nevada County, California

subject to the rights of defendant State Box Company under a contract of purchase entered into between it and said defendants, P. S. Waldron and Margaret A. Waldron; and that the United States of America, as between the parties to this action, is the owner of the fee title to said lands subject to the right of the defendants to remove the timber standing thereon.

That defendants shall have until November 1, 1951 to exercise their right to remove that timber which was growing on the land in question at the time of the grant and on which cutting rights have not been exercised, which is determined to be all timber of twenty-two (22) inches or more largest measure diameter breast high.

The court reserves the power to extend the time allowed for the removal of said timber should defend-

ants be prevented from removing the same by an order staying the judgment pending an appeal.

Dated January 20, 1950.

Dal M. Lemmon
United States District Judge

No. 18263

IN THE

United States Court of Appeals For the Ninth Circuit

STATE BOX COMPANY, *Appellant*

v.

UNITED STATES OF AMERICA, *Appellee*

Appeal From the United States District Court for the Northern District of California, Northern Division

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BRIEF FOR THE UNITED STATES

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INDEX

CITATIONS

CASES:

STATUTES AND REGULATIONS:

IN THE

United States Court of Appeals For the Ninth Circuit

No. 18263

STATE BOX COMPANY, *Appellant*

v.

UNITED STATES OF AMERICA, *Appellee*

Appeal From the United States District Court for the Northern District of California, Northern Division

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BRIEF FOR THE UNITED STATES

OPINION BELOW

The district court's memorandum opinion and findings of fact and conclusions of law appear at pages 46 and 79 of volume one of the reproduced record.

JURISDICTION

This is an appeal from a declaratory judgment obtained by the United States. The district court had jurisdiction under 28 U.S.C. sec. 1345. Its judgment was filed on August 7, 1962 (R. 89). Notice of appeal was filed on August 29, 1962 (R. 91). The jurisdiction of this Court rests on 28 U.S.C. sec. 1291.

QUESTIONS PRESENTED

1. Whether a federal statute granting timber on mineral lands to a railroad in 1862 required the grantee and its successors (here, State Box) to remove the timber within a reasonable time.

2. Whether the district court's finding and conclusion, supported by substantial evidence, that State Box and its predecessors failed to remove the timber within a reasonable time, can be set aside on State Box' appeal.

3. Whether State Box' claim to the timber, first asserted in 1958, is under the circumstances of this case barred by principles of adverse possession, abandonment, estoppel, and laches.

STATUTE INVOLVED

Section 3 of the Act of July 1, 1862, 12 Stat. 489, 492, provided:

> Section 3. And be it further enacted, That there be, and is hereby, granted to the said company, for the purpose of aiding in the construction of said railroad and telegraph line, and to secure the safe and speedy transportation of the mails, troops, munitions of war, and public stores thereon, every alternate section of public land, designated by odd numbers, to the amount of five alternate sections per mile on each side of said railroad, on the line thereof, and within the limits of ten miles on each side of said road, not sold, reserved, or otherwise disposed of by the United States, and to which a preemption or homestead claim may not have attached, at the time the line of said road is definitely fixed: *Provided,* That all mineral lands shall be excepted from the operation of this act; *but where the same shall contain*

timber, the timber thereon is hereby granted to said company. And all such lands, so granted by this section, which shall not be sold or disposed of by said company within three years after the entire road shall have been completed, shall be subject to settlement and preemption, like other lands, at a price not exceeding one dollar and twenty-five cents per acre, to be paid to said company. (Emphasis supplied.)

STATEMENT

This action was instituted by the United States to obtain a declaration that it was the owner of timber previously sold by it and to quiet its title to the timber remaining on lands owned by it (R. I 1-4). The district court noted that the "parties are in general agreement as to the basic facts," which are elaborated in the memorandum opinion and findings of fact (R. I 46, 79). The facts may be summarized as follows:

Sections 3 and 9 of the Act of July 1, 1862, 12 Stat. 489, 492, 493-494, as amended by Section 4 of the Act of July 2, 1864, 13 Stat. 356, 358, granted the Central Pacific Railroad Co.[1] the timber on all alternate section "mineral lands" within ten miles of its right of way, the mineral lands themselves being excepted from the grant. The lands involved were withdrawn for national forest purposes in 1902, were never patented, and are now part of the Tahoe Forest Reserve (R. II 18, 34; Pl. Ex. 1, 2). The timber on that part of section 15 involved here was included in a timber con-

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[1] For ease of reference the several corporations involved will hereafter be referred to as follows: The Central Pacific Railroad Co.—"Central Pacific"; the Central Mill Co.—"Central Mill"; the Tahoe Sugar Pine Co.—"Tahoe Sugar"; the State Box Co.—"State Box"; the Grizzly Creek Lumber Co.—"Grizzly Creek."

veyance in 1906 by Central Pacific to two individuals. Other timber conveyances followed. Timber was removed by these early timber purchasers. (R. II 42-47, 49-51; Def. Ex. A-E.) By 1912, this timber interest had been acquired by Central Mill (Def. Ex. F). The lands were formally declared to be "mineral lands" by the Department of the Interior in 1925 (Pl. Ex. 3).

In 1932, Central Mill entered into a timber cutting agreement with another company; the timber involved here was not described (R. I 65-70, 83; R. II 72-73; Pl. Ex. 33). In 1937, the Forest Service advertised for bids on timber included on this part of section 15. By mutual agreement, the successful bidder, which was the same company Central Mill had contracted with in 1932, ceased its logging operations before this timber in section 15 was reached. (R. II 19-20; Pl. Ex. 17, 18.) In 1944, Central Mill was dissolved, its sole surviving stockholder being appellant, State Box. Central Mill purported to have distributed "its known assets" and conveyed to State Box title to all certain real property and interests in specific timber; the timber involved here in section 15 was not described. (R. I 16-17, 42-43; R. II 58, 65; Pl. Ex. 31, 32; Def. Ex. H, I, K.) Also in 1944, State Box purchased all of the outstanding stock of Tahoe Sugar and sold it to various individuals who were also officials of State Box (R. I 17-18, 43-44; R. II 74-75).

The Forest Service again advertised for bids on this timber in 1955 (R. II 29-30; Pl. Ex. 27). Grizzly Creek was the successful bidder and purchaser (Pl. Ex. 26), but it is to be noted that one of the unsuccessful bidders was Tahoe Sugar, controlled since 1944 by some of the officials of State Box (R. I 17-18, 43-44; R. II 29-30, 74-75; Pl. Ex. 26A). Grizzly Creek in 1955

cut and removed timber under its contract, for which the United States received $86,254.13 (R. II 38).

Neither State Box nor Central Mill ever paid taxes on this timber located on section 15 (R. I 17, 31, 37, 43; Pl. Ex. 29). Nor did either protest any sale or attempted sale by the Forest Service or removal of the timber by vendees of the Forest Service prior to 1958 (R. I 7, 17, 19, 43, 45). In early 1958, a title searcher informed State Box that "record title" to the timber was in Central Mill (R. I 19, 45). State Box asserted its claim for the first time in June 1958 by letter to the Forest Service (R. I 10; Def. Ex. O). In July 1958, two individuals, who had been officers of Central Mill when it was dissovled in 1944, executed a deed which purported to convey to State Box all of Central Mill's real property, including timber, but again this particular timber was not described (R. II 59; Def. Ex. J). The Forest Service rejected State Box' claim in November 1958 (Def. Ex. O).

State Box then filed three actions, (1) an action in tort in a state court against Grizzly Creek in 1959; (2) an action in 1960 against the United States in the Court of Claims for an alleged taking in 1955 of timber; and (3) an action in 1960 in the United States District Court for the District of Columbia seeking to enjoin the Secretary of Agriculture from selling or removing remaining timber (R. II 10; Pl. Ex. 9, 9A, 9B, 9C, 10). Those three actions have been and are being held in abeyance pending decision of this suit, which was instituted in the court below by the United States.

The district court's memorandum and order were entered in May 1962, after trial before the court without a jury (R. I 46). Thereafter, in August 1962, findings of fact and conclusions of law were filed (R.

I 79), and judgment was entered for the United States (R. I 89).[2] This appeal by State Box followed.

SUMMARY OF ARGUMENT

The 1862 Act, as construed by the courts, and related statutes support the view that State Box and its predecessors did not receive, and Congress did not intend for them to receive, a grant in perpetuity as to timber on "mineral lands." Of course the federal grant is to be construed strictly against the grantee so as to withhold that which is not expressly granted. So far as possible, statutes should be construed to reconcile rather than to create conflicting rights. And the construction of the federal grant of real property interests in several states is manifestly a matter of federal law. (We question whether even California law would permit a result which would fetter real property interests indefinitely.)

The common law rule requires the removal of timber within a reasonable time where the conveyance is silent as to time. The district court found that State Box and its predecessors failed to remove the timber within a reasonable time. That finding is supported by substantial evidence and is unchallenged by State Box. The facts of this case also show that State Box' claim is barred by principles of adverse possession, abandonment, estoppel, and laches.

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[2] State Box' counterclaim for recovery of the proceeds of the 1955 timber sale was opposed by the United States (R.I 11, 14). State Box ultimately conceded that the district court "does not have jurisdiction to render the affirmative money judgment sought by the counterclaim" (Def. Trial Br., p. 17, filed November 13, 1961). The district court stated that it need not consider the counterclaim, but its holding on the Government's case, we believe, effectively and correctly disposed of the counterclaim (R.I 62). *United States* v. *Shaw*, 309 U.S. 495, 502-505 (1940).

ARGUMENT

I

Title to the Timber Sold in 1955 and Also to the Timber Remaining on the Land Involved Was Correctly Quieted in the United States

A. *The statute did not grant to State Box or its predcessors a perpetual estate in the timber.*—It is settled law that federal grants are to be construed strictly against the grantee so as to withhold that which is not expressly granted. As stated in *Caldwell* v. *United States,* 250 U.S. 14, 20 (1919), "statutes granting privileges or relinquishing rights are to be strictly construed; or, to express the rule more directly, that such grants must be construed favorably to the Government and that nothing passes but what is conveyed in clear and explicit language—inferences being resolved not against but for the Government." See also *United States* v. *Union Pacific R. Co.,* 353 U.S. 112, 116 (1957); *Great Northern Ry. Co.* v. *United States,* 315 U.S. 262, 272 (1942); *United States* v. *Oregon and California R. Co.,* 164 U.S. 526, 539 (1896).

It is also clear that, under a conveyance of timber silent as to time, the common law rule requires the removal of the timber within a reasonable time. The principle is stated in 2 Tiffany, *The Law of Real Property* (3d ed. 1939) sec. 597, p. 537, as follows:

> Even in the absence of an express limitation as to the time of cutting and removal, the courts, moved by a desire to prevent the operation of a mere conveyance of trees as in effect a conveyance of the soil on which the trees are growing, tend to imply a requirement that the trees shall be cut and removed within a reasonable time, with a resulting loss of all right to trees not removed within such time.

See *United States* v. *Wheeler,* 161 F. Supp. 193, 197-198 (W.D. Ark. 1958). Directly in point is the ruling in *United States* v. *Power* (N.D. Cal., No. 13713, 1909) unreported (Pl. Ex. 30, p. 4):

> 2. The act making the grant to the Central Pacific Railroad Company contains the proviso; "Provided that all mineral land shall be excepted from the operations of this act, but where the same contains timber, the timber thereon is hereby granted to said company." If, therefore, the land, described in the complaint, is mineral land, as claimed by the plaintiff, then the defendant, as successor in interest of the Central Pacific Railroad Company, had the right to remove the timber thereon unless such right had been forfeited. There is no time specified in the act within which the grantee was required to remove such timber, and the general rule, as applied to grants of that character, as between private persons, is that the grantee has a reasonable time within which to remove the same [citations omitted].
>
> I am of the opinion that the same rule is applicable to the grant under which the defendant claims. * * *

The purpose of the 1862 Act was to aid the railroads in the construction and operation of their lines. *United States* v. *Union Pacific R.R. Co.,* 91 U.S. 72, 79-82 (1875). There is, however, no affirmative expression in the statute of a congressional intent to grant timber on mineral lands *in perpetuity*[3] and the

---

[3] The use of a form of the word "grant" does not, of course, mean that a grant *in perpetuity* was intended. Though the word "grant" or a form of it is commonly used in timber conveyances, the common law requires removal within a reasonable time. See, e.g., *R.F.C.* v. *Sun Lumber Co.*, 126 F.2d 731 (C.A. 4, 1942); *Thomas* v. *Gates,* 31 F.2d 828 (C.A. 4, 1929), cert. den., 280 U.S.

legislative history of the statutory language concerning timber is not enlightening on the question.[4] In this situation it must be assumed, we submit, that Congress was aware of the common law rule which requires the removal of timber within a reasonable time and intended the grant of timber on mineral lands to end when the purpose of the statute was accomplished.

Other provisions of the relevant statutes indicate that it was understood that the grants were made to realize the fulfillment of the purpose within a reasonable time in the future and that no permanent interest in timber was intended. For example, Section 3 of the 1862 Act provided that the railroad was to sell all of its land grant within three years, "after the entire road shall have been completed,"[5] failing which the United States could sell such land itself for the benefit

559 (a diversity case, properly applying state law, in which neither the United States nor a federal grant was involved); *Tennessee Mining & Mfg. Co.* v. *New River Lumber Co.*, 5 F.2d 559 (C.A. 6, 1925); *Granville Lumber Co.* v. *Atkinson*, 234 Fed. 424 (E.D. N.C. 1916). *Carr* v. *Central Pacific R. Co.*, 55 Cal. 192 (1880), cited by State Box (Br. 14), merely determined that as between the railroad and a subsequent mineral patentee, the railroad had title to the timber. This 1880 four-line opinion does not decide that a perpetual estate in the timber was intended by the 1862 statute as against the United States.

[4] The provision concerning timber was not in the original House bill, H.R. No. 364. Senator Wilson of Massachusetts proposed the provision on the floor of the Senate as an amendment. He said: "I will simply say in support of the amendment that one of the great difficulties of constructing and running a Pacific railroad will be the want of timber, and, therefore, as these lands are covered with timber, I hope this amendment will be adopted. It will be for the interests of the country." The amendment was routinely adopted by both houses without debate and was considered by the House as one of several immaterial Senate amendments. Cong. Globe, 37th Cong., 2d Sess. 2813, 2905 (1862).

[5] In 1862, it would have been absurd for Congress to attempt to predict the time of completion of the railroad.

of the railroad. Similarly, Section 4 of the 1862 Act provided for the issuance of patents conveying the title to granted lands to the railroad upon completion of each 40 consecutive miles of road. (Section 6 of the 1864 Act reduced the requirement to each 20 consecutive miles.) A patent, or a clear listing, is the indicium of a permanent interest and the basis of any chain of title. But no provision was made for the patenting or clear listing of timber on mineral lands. Section 5 of the 1864 Act extended by one year certain time limits imposed on the railroads, and required Central Pacific "to complete twenty-five miles of their said road in each year thereafter, and the whole to the state line within four years * * *."

Only a few years later, in enacting the first mining law permitting the patenting of mineral lands, Congress made no special exception as to prior grants of timber on mineral lands and did not reserve timber granted to a railroad from the patent. Act of July 26, 1866, 14 Stat. 251, as amended by the Act of May 10, 1872, 17 Stat. 92, 30 U.S.C. sec. 29. Also noteworthy is the fact that Section 21 of the 1864 Act required payment of the costs of surveying "before any land granted by this act shall be conveyed to any company or party entitled thereto under the act." This particular area was surveyed as early as 1874, but no surveying costs as to section 15, the land on which the timber involved here is located, were ever paid by the railroad.

To a degree there is a conflict of rights between the mineral reservation and the timber grant to the railroad. Congress made effective the mineral reservation by providing for mining development and possible fee patents under the mining laws. Ordinarily a min-

ing locator is entitled to use the timber on his location for mining purposes and secures complete title to the timber when he qualifies for his fee patent.[6] *United States* v. *Etcheverry,* 230 F. 2d 193 (C.A. 10, 1956), and cases there cited. Timber ownership by the railroad is thus inconsistent with the mining locator's rights. While the railroad prevails over any mineral locator during construction of the road, no reason appears why that conflict should be extended in perpetuity. Reconciliation of the two rights so far as possible requires, we submit, that the railroad, or its successors, exercise its rights within a reasonable time.

Moreover, in *United States* v. *Union Pacific R. Co.,* 353 U.S. 112, 117, 120 (1957), the Supreme Court construed the reservation of "mineral lands" in one section of the 1862 Act to apply to mineral rights in the right-of-way granted in another section of the statute. The Supreme Court would not "assume that the Thirty-seventh Congress was profligate in the face of its express purpose to reserve mineral lands" and "would [not] make a violent break with history * * * [by construing] the Act of 1862 to give such a bounty" as against the United States. So, here, this Court should not construe the grant of timber, for the purpose of aiding in the construction and operation of railroads, to give a bounty as against the United States in favor of State Box, a company not engaged in railroad enterprises, more than 100 years after the enactment of the statute, for a use totally unrelated to the purpose of the 1862 Act.

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[6] In 1955 Congress amended the mining laws for the purpose of assuring that removal of timber by mining locators is to be for use for mining purposes. Act of July 23, 1955, 69 Stat. 368, 30 U.S.C. sec. 612.

B. *Application of state law in construing the federal timber grant and in determining the estate granted was properly rejected.*—In its memorandum opinion, the district court said (R. I 54-55):

> It is apparent that, when dealing with a United States statute which affects real property in numerous States, the law of the United States alone must control the disposition of title to its lands [citations omitted]. The disposition of such lands is a matter of the intention of the grantor, the United States.
>
> The policy set forth in *Clearfield Trust Co.* v. *United States,* 318 U.S. 363 [1943], is here applicable, namely that in the absence of a specific statutory provision, the application of state law is denied where it would make identical transactions subject to the vagaries of the laws of the several states. The construction of grants by the United States is a federal, not a state question, and involves the consideration of state questions only insofar as it may be determined as a matter of federal law that the United States has impliedly adopted and assented to a state rule of construction as applicable to its conveyance [citations omitted].

It is submitted that the district court's conclusion is eminently correct. The applicable rule was thus stated in *United States* v. *Oregon,* 295 U.S. 1, 28 (1935):

> The construction of grants by the United States is a federal not a state question, [citations omitted] and involves the consideration of state questions only insofar as it may be determined as a matter of federal law that the United States has impliedly adopted and assented to a state rule of construction as applicable to its conveyances. * * *

See also *Borax, Ltd.* v. *Los Angeles,* 296 U.S. 10, 22 (1935); *Chapman & Dewey* v. *St. Francis,* 232 U.S. 186, 196 (1914). Moreover, the Supreme Court has construed these same statutes twice recently with no mention of the relevance of state law. *United States* v. *Union Pacific R. Co.,* 353 U.S. 112 (1957); *Great Northern Ry. Co.* v. *United States,* 315 U.S. 262 (1942).

State Box contends that, under California law, since forfeitures are abhorred, a timber conveyance silent as to time does not require removal of the timber within a reasonable time (Br. 15-17). Indeed, it would construe the grant as imposing no obligation to remove the timber "within ten years or twenty years or fifty years or one hundred years * * *" (Br. 11). It is significant, we submit, that State Box cites no California case which decides that a timber conveyance silent as to time does not obligate the *grantee* to remove the timber within a reasonable time. Moreover, we question whether the California rule would embrace a construction that would allow a timber grantee to tie up the land indefinitely, "for a period which could not be measured, or, perhaps for all time * * * [i]n the absence of language in the contract plainly and unequivocally disclosing such intent * * *." *Woodard* v. *Glenwood Lumber Co.,* 171 Cal. 513, 522, 153 Pac. 951, 955 (1915); see also *United States* v. *Power* (N.D. Cal., No. 13713, 1909) unreported (Pl. Ex. 30, p. 4); *Mallett* v. *Doherty,* 180 Cal. 225, 180 Pac. 531 (1919); *Call* v. *Jenner Lumber Co.,* 33 Cal. App. 310, 165 Pac. 23 (1917). But if appellant is right as to California law, we submit that it would be absurd so to apply the grant in California when the same words, as appellant admits (Br. 21), also grant lands and rights in "Nebraska, Wyoming, Utah and Nevada * * *."

In this connection, State Box refers to *United States* v. *Waldron* (N.D. Cal., No. 6105, 1949) unreported. As the district court here observed (R. I 51, 85), it had not been established on the facts of that case that Waldron had had a reasonable time to remove the timber. Taking judicial notice of the *Waldron* records and noting that State Box was a party to the *Waldron* case (R. I 51, 85), the district court here stated (R. I 57-58; emphasis by the court):

> Defendant [State Box] can gain no comfort from *United States vs. Waldron,* No. 6105, records of this Court. There is language in that case, to be sure, that the rule of *Gibbs vs. Peterson,* 163 Cal. 758, was to be applied. But the results of the *Waldron* case were that additional time was given the defendants to exercise their rights of cutting timber (along with a finding that a reasonable time had *not* passed during which the timber should have been cut). Later, on March 30, 1953, a final decree was entered in the case adjudging that the defendants had exercised their rights of cutting timber, that they no longer had any right, title or interest in such timber, *and that the Government was then the legal owner of all remaining timber* on said land. In other words, the reference to *Gibbs vs. Peterson* was specifically for the purpose of framing an order allowing the Waldrons to continue cutting on the land involved for a specified time, after which time the timber would revert back to the Government.

The case thus stands for the proposition that the timber grant was not a perpetual one.

C. *The finding that State Box and its predecessors failed to remove the timber within a reasonable time is supported by substantial evidence.*—In this case, the

district court found that State Box "and its predecessors in title did not remove the timber from section 15 within a reasonable time although opportunity to do so existed" (R. I 85). That finding is supported by substantial evidence. We do not know whether the railroad could have removed the timber in the 1880s, but the evidence adduced did show that by 1902, there was definite lumbering activity in the area and adequate road facilities to reach section 15, to remove the timber to nearby mills, and to take the finished product to market (R. II 43-47, 49-50). There was a demand for timber at that time for the construction of large flumes in the nearby Bowman Lake area and for mining purposes (R. II 44-45, 47). There was also some demand for building purposes (R. II 48). A mill was constructed within three miles of section 15 and there was easy access to that mill from section 15 (R. II 43-44). Of course the railroad was only ten miles away. Further, the United States sold some of this and other timber in the area in 1937 (R. II 19-20), and, beginning in 1945, the United States made numerous timber sales on adjoining sections, which sales were completed and stipulated by State Box at the trial (R. II 21-22, 24, 32-33; Pl. Ex. 19). Following World War II, there was an increased demand for timber (R. II 26-27). Much of the timber on the patented mining claims in section 15 had been cut and removed prior to 1953 (R. II 25, 50-51). Grizzly Creek cut and removed timber under its contract in 1955 (R. II 31, 38). Access roads were also available during the period of these later sales (R. II 22-25, 31).

State Box does not contend that the evidence does not support the district court's finding. It therefore concedes the point, and the federal appellate courts do

not retry facts and will not set aside findings supported by substantial evidence, which here consisted of "admitted facts" and testimony at the trial. It is "the immemorial canon that, given substantial evidence to support its judgment, the trial court must have its way." *Coleman Co.* v. *Holly Mfg. Co.,* 269 F. 2d 660, 661, 665 (C.A. 9, 1959). See also *Lowe* v. *McDonald,* 221 F. 2d 228, 230 (C.A. 9, 1955); *Wittmayer* v. *United States,* 118 F. 2d 808, 809-811 (C.A. 9, 1941).

II

State Box' Claim Is Barred By Principles of Adverse Possession, Abandonment, Estoppel, and Laches

Preliminary to reciting additional facts which buttress the district court's result, we advance several germane principles. Under California law, the statutory period of adverse possession is five years. Cal. Code Civ. Proc., secs. 318, 322.[7] "The right to standing timber may be acquired by adverse possession." 2 Tiffany, *The Law of Real Property* (3d ed. 1939) sec. 595, p. 533; see *Red River Lumber Co.* v. *Null,* 66 Cal. App. 499, 505-506, 226 Pac. 812, 814-815 (1924). Further, a timber right may be lost by abandonment. In determining whether such a right has been abandoned, the grantee's nonpayment of taxes and failure to cut and remove the timber are given great weight. The timber reverts to the owner of the fee upon establishment of abandonment. *United States* v. *Wheeler,* 161 F. Supp. 193, 198 (W.D. Ark. 1958). Also, a party will be estopped to claim title when others have relied

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[7] There is no inconsistency between reference by the United States to state law in this phase of the case and its insistence that the title granted by it under the federal statute is to be determined by federal law.

upon his action or inaction. See *First National Bank of Portland* v. *Dudley,* 231 F. 2d 396, 400-401 (C.A. 9, 1956); *James* v. *Nelson,* 90 F. 2d 910, 917-918 (C.A. 9, 1937), cert. den., 302 U.S. 721. The doctrine is available to a plaintiff in a case where a defendant claims title. *Wehrman* v. *Conklin,* 155 U.S. 314, 332-333 (1894); *George* v. *Tate,* 102 U.S. 564, 568 (1880); cf. *Albert* v. *Joralemon,* 271 F. 2d 236, 240-241 (C.A. 9, 1959). And laches, a principle involving only the passage of time, operates to prevent a party, who has slept on his rights, from complaining of the loss of those rights. *Russell* v. *Todd,* 309 U.S. 280, 287-289 (1940). It applies to suits concerning interests in real property, *Abraham* v. *Ordway,* 158 U.S. 416, 422 (1895); *Godden* v. *Kimmel,* 99 U.S. 201-202, 208-212 (1878), and may be asserted by a plaintiff. *Adair* v. *Shallenberger,* 119 F. 2d 1017, 1020 (C.A. 7, 1941).[8]

In this case, the facts show that whatever interest State Box and its predecessors may have once had in the timber had been lost long before 1955 when the United States and Grizzly Creek contracted for the sale of some of the timber. Those facts may be particularized as follows:

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[8] It was stated in *Northern Pacific R. Co.* v. *United States,* 277 F.2d 615, 624-625 (C.A. 10, 1960), that the plaintiff, the United States, could not invoke laches "to bar rights asserted by defendant merely by way of defense" because the defendant's counterclaim had been dismissed earlier in the proceedings and because of the immunity of the United States. We believe that holding to be erroneous. *Stanley* v. *Schwalby,* 147 U.S. 508, 517 (1893). We further believe, as the cases cited above hold, that estoppel and laches can be relied on by a plaintiff. Moreover, the Tenth Circuit's holding is clearly irrelevant to the case at bar in the light of State Box' counterclaim for title which was not dismissed earlier in the proceedings (R. 6-11) and the availability of relief against the United States in the Court of Claims. *Malone* v. *Bowdoin,* 369 U.S. 643, 647, note 8 (1962).

1. Central Pacific never pretended to have acquired more than an interest in timber on the lands involved. It paid no surveying costs, as required by statute, though the area was surveyed as early as 1874. Neither Central Pacific nor any of the subsequent grantors ever conveyed an interest other than an interest in timber, even before the lands were formally declared to be "mineral lands" in 1925. The timber involved has never been described in a conveyance of any kind since 1912, when various individuals conveyed this and other timber to Central Mill (Def. Ex. F, G).

2. The lands were withdrawn for national forest purposes in 1902 and were placed within the Tahoe Forest Reserve in 1906. The lands have been administered as part of the Tahoe National Forest and the timber has been given fire protection and care by the United States, which has exercised possessory rights to the timber for at least 20 years (R. II 18-19).

3. The timber involved was not described by Central Mill in its 1932 timber contract with another company, although that contract, as found by the district court without challenge by State Box, described all other timber it had received in 1912 (R. I 65-70, 83; R. II 72-73; Pl. Ex. 33).

4. In 1937, the Forest Service advertised for bids on timber included on this part of section 15. The successful bidder was the same company Central Mill had contracted with in 1932. Central Mill lodged no protest to the sale (R. II 19-20; Pl. Ex. 17, 18).

5. Section 321 of the Transportation Act of 1940, 54 Stat. 954-955, 49 U.S.C. sec. 65(b), provides that upon the filing of a waiver to its remaining land grant

claims, including "interests in lands," a railroad would not be required to give special rates to the United States. Such interests previously patented to a railroad or sold by a railroad to an innocent purchaser for value were excluded. Regulations relating to this Act required a railroad to list all such interests previously conveyed. 43 C.F.R. 273.65 (1944 Cum. Supp.); 43 C.F.R. 273.68 (1954 ed.). In October 1940, the Southern Pacific Co., on behalf of Central Pacific, filed a release. It made no references to any conveyances affecting this particular land (Pl. Ex. 4-8).

6. In 1944, when Central Mill was dissolved, it purported to have distributed "its known assets" and conveyed to State Box, its sole surviving shareholder, title to all certain real property and interests in specific timber; it did not describe this timber on section 15 (R. I 16-17, 42-43; R. II 58, 65; Pl. Ex. 31, 32; Def. Ex. H, I, K).

7. Following *United States* v. *Waldron* (N.D. Cal., No. 6105, 1949), unreported, the United States entered into agreements with a number of similarly situated timber claimants, including State Box and Tahoe Sugar (Pl. Ex. 20-25), under which timber was to be removed within a reasonable time and a quitclaim deed executed to the United States. State Box never requested such an agreement as to this timber, and admits that it did not even know that it might have a claim until 1958 (R. I 10, 19, 45; Def. Ex. O).[9]

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[9] *Waldron* is distinguishable on several grounds. First, the conveyance to Waldron's predecessors in interest was directed to the attention of the United States in 1945 (Pl. Ex. 7, 8). Second, Waldron paid taxes continuously from 1903 and from 1924 to 1937 paid a fire protection tax to the Forest Service. Third, the evidence in this case relating to early timber operations and markets

8. Neither State Box nor Central Mill ever paid taxes on this timber or paid for its protection and care (Cal. Rev. & Tax Code, secs. 104, 107; R. I 17, 31, 37, 43; R. II 18-19; Pl. Ex. 29).

9. Neither Central Mill nor State Box ever protested a sale by the Forest Service or removal by vendees of the Forest Service prior to 1958 (R. I 7, 17, 19, 43, 45).[10]

10. Tahoe Sugar, controlled since 1944 by some of the officials of State Box, was one of the unsuccessful bidders at the advertised sale of some of this timber to Grizzly Creek in 1955 (R. I 17-18, 43-44; R. II 29-30, 74-75; Pl. Ex. 26A).

These facts, we believe, support a denial of State Box' claim under the principles of adverse possession, abandonment, estoppel, and laches.

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is entirely different. Fourth, since 1949, a particularly good lumber market has existed, there have been large-scale timber operations in the area, and the road referred to in the *Waldron* Finding V has been in continuous existence (State Box App. iv). Finally, the district court found that Waldron "had consistently asserted title" to the timber involved in that case (R.I 85). That finding is unchallenged by State Box.

[10] State Box curiously urges, "Ever since the acquisition of title by The Central Pacific Railroad, the ownership of the timber by the railroad and its successors has been readily apparent from an examination of the official records * * * " (Br. 25). Even if that were so, it would only operate to demonstrate the laches of State Box and its predecessors. The record is plain that this claim is an afterthought as a result of a title examiner's report without regard to any of the above-recited facts.

CONCLUSION

For the foregoing reasons, the judgment should be affirmed.

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APRIL 1963

Certificate of Examination of Rules

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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No. 18265

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LARRY'S SANDWICHES, INC., a California corporation,

Appellant,

vs.

PACIFIC ELECTRIC RAILWAY CO., a California corporation,

Appellee.

Appeal From the United States District Court for the Southern District of California Central Division.

BRIEF FOR APPELLEE.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

CASES PAGE

PAGE

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BRIEF FOR APPELLEE.

Statement of the Case.

This is an action founded on negligence. There was considerable conflict in certain aspects of the evidence, and hence Appellee cannot agree with the contention there was "very little conflict in the evidence of the parties. . . ." (Appellant's Br. p. 5). It is true that Appellee's evidence of due care in the handling of the car in transit by all the participating railroads was virtually uncontroverted. It is also true that evidence of the parties was without conflict that at least part of the shipment of sandwiches was in an unfrozen

condition when the car arrived at Chicago. Beyond that, there was considerable evidence that raised a reasonable doubt as to whether or not all the sandwiches were actually frozen when tendered to the Appellee at Culver City. Thus, the evidence was conflicting as to the reason for the "bad order" of the shipment at destination.

Appellee offered evidence that the participating carriers were free from negligence, that the car was transported with reasonable dispatch, and that the carriers strictly complied with the instructions given by Appellant, as shipper, and with the rules of the published tariff. It based its defense primarily upon those propositions. Secondly, it endeavored to show there was a reasonable possibility that at least part of the shipment (that which was found to be unfrozen at Chicago) was never in a frozen condition when loaded at Culver City. The sandwiches were not subject to visual inspection at the time of loading, because they were individually wrapped in foil, sealed, and placed in a cardboard box which, in turn, was placed in a corrugated paper case and sealed with tape. The lading was not observed by anyone enroute, for the car was loaded by the shipper, the doors sealed at origin and not unsealed until it reached destination. As a consequence, Appellee relied upon the bill of lading recitation that the shipment was received by it from the shipper only "in apparent good order, except as noted (contents and condition of contents of packages unknown)."

It is true the District Court made no finding of fact as to whether or not the shipment was frozen and otherwise in good condition at the time of delivery to the Appellee. The reason therefor is that under the evidence the Court could make no such finding, but could only find the condition to be as agreed to by the parties and stated in the bill of lading, which finding was in fact made [R. A. p. 43, lines 12-15].

Appellant did not quite accurately state the legal premise upon which judgment was rendered for Appellee. One important element of the premise was omitted. Appellant failed to state (Appellant's Br. p. 7) that the Court on overwhelming and uncontroverted evidence found that Appellee was free from negligence, had carried out the shipping instructions, and had complied with all tariff rules, and that after such showing the Appellant *then* failed in his cause because he could not show some specific negligent conduct, which he had a duty by law to prove. He failed, not because such burden was not met in his direct case or case in chief, but because in rebuttal he failed to sustain his burden of overcoming Appellee's proof. This is the crux of the matter. Thus, again this Court is presented with a freight loss and damage case involving ". . . a step-by-step progression through an accepted scheme of shifting burdens of proof. . . ." (*Daido Line v. Thos. P. Gonzalez,* 9th Cir., 1962, 299 F. 2d 669, 671).

ARGUMENT.

Appellant in Point 5 of its brief, pages 30 to 41, has challenged findings VII, VIII and IX as being against the weight of the evidence. The following is submitted pursuant to the requirement of Rule 18(3) of this Court, specifying that Appellee's Brief contain record references to the evidence supporting the challenged findings.

I.

The Evidence Overwhelmingly Supports the Finding of Compliance With Provisions of the Bill of Lading and of Applicable Protective Tariff Rules and Regulations (Finding VII).

(a) Section 2(a) of the Contract Terms and Conditions of the bill of lading [Ex. 4] provides that:

> "No carrier is bound to transport said property by any particular train or vessel, or in time for any particular market or otherwise than with reasonable dispatch."

The shipment departed Culver City on July 21, 1960, and arrived in Chicago and was delivered to the consignee on July 27, 1960, a lapse of six days, which was a reasonable time for the transportation thereof [Tr. p. 259]. Appellant offered no evidence that the shipment was not transported with reasonable dispatch.

(b) Rules 130 and 135 of the Perishable Protective Tariff No. 18 [Ex. J], applicable to this shipment, provide as follows:

"Rule 130

CONDITION OF PERISHABLE GOODS NOT GUARANTEED BY CARRIERS

Carriers furnishing protective service as provided herein do not undertake to overcome the inherent tendency of perishable goods to deteriorate or decay, but merely to retard such deterioration or decay insofar as may be accomplished by reasonable protective service, of the kind and extent requested by the shipper, performed without negligence."

"Rule 135

LIABILITY OF CARRIERS

Property accepted for shipment under the terms and conditions of this tariff will be received and transported subject to such directions, only, and to such election by the shipper respecting the character and incidents of the protective service as are provided for herein. The duty of the carriers is to furnish without negligence reasonable protective service of the kind and extent so directed or elected by the shipper and carriers are not liable for any loss or damage that may occur because of the acts of the shipper or because the directions of the shipper were incomplete, inadequate or ill-conceived."

(c) The evidence supporting Finding VII generally and the exercise of ordinary care and the furnishing of reasonable refrigerated protective service [Find. VIII] by Appellee and its connecting carriers, is as follows:

Although Appellant failed to comply with Rule 705 of the Perishable Protective Tariff [R. A. p. 34] by placing on the bill of lading [Ex. 4] the requisite notation that mechanical protective service for frozen commodities was desired by the shipper, it was conceded at the trial by Appellee that the shipment was handled in transit as a frozen shipment, although the contents and the condition thereof when tendered at point of origin, insofar as Appellee was concerned, was only that as described in the bill of lading.

Appellant concedes that at the time the car was being loaded at Culver City, on July 20 and 21, 1960, the air temperature inside thereof was cold (below 10°) and it was in good working order [Tr. pp. 74 and 129]. The car in which the shipment was transported was a new mechanical refrigerator railroad car, having been initially placed in service in May, 1960 [Tr. pp. 377-378]. It was of the type ordered by Appellant [Tr. p. 263]. It was of the latest design and construction [Tr. pp. 379-392]. The trip involved was the third trip the car had made since initially placed in service [Tr. p. 377; Ex. "A"]. The shipment was loaded by Appellant and the doors of the car were sealed by the shipper at origin [Tr. pp. 258-259]. The seals were intact at destination [Supplementary Stipulation of Facts, R. A. p. 32], indicating that the doors were not opened in transit, that the load was not disturbed by outsiders enroute, and that the carriers had no means of ascertaining the condition of the shipment before it was delivered to the consignee.

The inspection report [Ex. "A"] which accompanied the car from origin to destination shows these perti-

nent facts, written thereon by the various employees of the carriers who had occasion to observe the car and the mechanical functioning thereof:

The mechanical refrigeration system was started at 8:00 A.M. on July 19, 1960, at which time the thermostat was set for −5°; that the car was inspected enroute at Colton, California, Tucumcari, New Mexico, Kansas City, Kansas, Silvis, Illinois, and Burr Oak, Illinois, and in each instance the diesel engine that runs the refrigeration system was found to be properly operating and that the highest degree of temperature observed in transit by any such inspecting employee was +7°.

The station service reports of inspection attached to affidavits of the inspectors were received in evidence as Exhibits "C", "D", "E", "F", "G", "H" and "I". They, together with Exhibit "A", show in detail the observations made of the car from the time it was ordered by the Appellant at Los Angeles, until it was delivered to the consignee at destination. In each instance, the record shows satisfactory thermometer readings to safeguard a frozen shipment, the proper functioning of the diesel engine, and an adequate fuel supply.

The only record of handling of the car which required explanation was the broken street ell episode at Chicago, occurring on the evening of July 26, 1960. The fact that the carrier involved exercised ordinary care in making repairs within approximately two hours after the defect was observed was shown by the testimony of the refrigeration repairman [Tr. pp. 274-303]. By his testimony, it was shown that while the engine was

not operating the temperature inside the car did not rise above 12°, and that this temperature was immediately reduced to 6° as soon as the temporary repairs were made, the engine was started, and the air was again circulating. The conclusion is that the air temperature measured by the thermometer in the air chamber adjacent to the compressor, while the air was not circulating, was higher than the air in the chamber surrounding the lading [Tr. pp. 412-414]. In fact, the air surrounding the lading did not rise above 6° inasmuch as this temperature reading was observed on the thermometer by the repairman within 30 or 40 minutes after the engine was restarted and the air circulation resumed [Tr. p. 287].

Upon return to Los Angeles, the car's thermostat and thermometer were on August 16, 1960, tested for accuracy by use of a potentiometer and a thermocoupler. Both were found to be functioning in a proper manner [Tr. p. 485, line 23, to p. 486, line 1], the thermometer itself being off only ½ of a degree.

(d) There was no evidence that any act or omission on the part of Appellee or its connecting carriers was the proximate cause of the loss [Find. IX], but there was considerable convincing evidence all the sandwiches were not frozen when tendered to Appellee at origin, thus furnishing proximate cause. Appellant testified that the sandwiches after manufacture were placed in the freezer, where they remained for a minimum of 24 hours before being taken out and shipped [Tr. p. 25]. The first-in and first-out method was used [Tr. p. 25]. At the time a box of sandwiches came off the assembly line, it was marked in chalk

with the day of the month before it was placed in the freezer [Tr. pp. 22 and 107]. After taking the sandwiches out of the freezing room, the pulp temperatures were taken before they left the plant, but no record of such temperatures was made [Tr. p. 109]. In fact, there was a singular lack of record keeping by Appellant in any phase of the freezing process. For example, the thermometer temperatures in the freezer were read three or four times per day, but no log of the readings was kept [Tr. p. 105]. It was Appellant's opinion that to be frozen a sandwich must be reduced to a temperature below 28°, and under normal operations at load time the range would be from zero to even –10° or up to 20° [Tr. p. 70]. It was his opinion that the lading would rise only 5° during a slow loading process [Tr. p. 71], but might be as high as 20° or 25° at the time of loading [Tr. p. 110]. It took approximately two days to load the rail car involved [Tr. pp. 37-38]. The merchandise was trucked for one mile from the plant to the rail car [Tr. p. 70]. The trucks used in the transportation of the lading from the plant to the car were not refrigerated [Tr. p. 28]. During the loading process, the car door was open during the length of time it would take to unload the truck, which Appellant estimated to be between one and one and one-half hours [Tr. p. 72]. No effort was made to shroud the opening between the rail car and the back end of the truck during loading [Tr. p. 112]. Thus, the total elapsed time the commodity was out of the freezer until it was loaded was approximately two hours [Tr. p. 72]. A truck would hold approximately 400 cases and three or four

truckloads per day were loaded [Tr. p. 73]. After loading was completed, Appellant sealed the rail car doors [Tr. p. 40]. A total of 2316 cases were loaded [Ex. 4].

On direct, Appellant's witness stated there were three doors in the freezing room [Tr. p. 101], but on cross-examination, he conceded two of the three doors were only 18 or 20 inches square and that doors of such size could not accommodate a palletized load [Tr. p. 132]. The boxes of sandwiches were stacked on pallets when placed in the freezer [Tr. pp. 17-18]. Since no in and out records were kept, considerable doubt existed as to whether the first in were actually the first out, as Appellant testified. The freezing room was 40′ by 18′ and would hold approximately 100 pallets, of the 28″ by 32″ size used by Appellant. With 100 palletized loads in the freezer at a time, containing 3500 cases of sandwiches, there would be no aisle room left for maneuvering pallets [Tr. pp. 100-101]. Although every case was marked, according to the Appellant's testimony [Tr. pp. 22 and 107], the Western Weighing and Inspection Bureau Inspector at Chicago stated he saw no chalk marks, code marks or lot numbers on any of the cases [Tr. p. 333]. The Bureau Inspector at Chicago spent one hour inspecting the load [Tr. p. 332] on July 28, 1960, the day after the car arrived [Tr. p. 327]. He opened 20 cases during this inspection [Tr. p. 336], but had a very difficult time finding a case that was warm and sandwiches moldy [Tr. p. 336]. After considerable searching, he finally found one that was warm to the touch, located 3 rows from the wall and in the fourth layer from the top of

the load [Tr. p. 336]. It was directly adjacent to boxes that were cool to the touch and which contained frozen sandwiches. The warm sandwiches had a temperature of 64°, causing the witness to conclude that it was not frozen when originally put in the car [Tr. p. 337]. Boxes of warm sandwiches were found interspersed in the load, with frozen sandwiches adjacent thereto [Tr. p. 340]. Pulp temperatures ranging from 16° to 64° were found. In boxes that were frozen, he observed pulp temperatures ranging from 16° to 22°. In boxes not frozen, he observed a range of temperatures from 44° to 64° [Tr. p. 340]. No warm or moldy sandwiches were found in the periphery of the load. He was particularly looking for such sandwiches in the periphery, because where there is in-transit defrosting, such sandwiches are found around the top of the load and in the sides of the load first [Tr. p. 341]. Sandwiches located next to the sides of the car had a range in temperature from 16° to 22° [Tr. p. 357]. He found one warm box of 44° and frozen boxes on either side [Tr. p. 359]. He found another box with a temperature of 64°, and all the boxes around it were in a freezing condition [Tr. p. 360]. He took pulp temperatures in that portion of the load which had not previously been disturbed by others who had entered the car before he did [Tr. pp. 331-332]. He took approximately 35 pulp temperatures [Tr. p. 367] and only a few of the sandwiches he observed (5 to 10%) were moldy [Tr. p. 368].

The Chief Engineer for the Pacific Fruit Express Company [Tr. p. 373], which company owned the refrigerator car, testified concerning the design and con-

struction thereof. He was personally responsible for the design of the refrigerating, air conditioning and air circulating system within this car [Tr. p. 377]. It was equipped with a diesel engine, compressor and cooling coils, through which cold air was blown by a blower, causing the air to circulate in the flue in the sides, end wall, ceiling chamber and space under the floor racks [Tr. p. 387]. There were air openings in the ceiling, permitting air to travel through the lading compartment [Tr. p. 387]. The sensing elements of the thermostat [Tr. p. 391] and for the thermometer [Tr. p. 392] are located in the return air stream, which is warmest air in the car. Thus, a weighted average of all temperatures in the car, including the lading, is measured [Tr. pp. 393-394]. The thermometer measuring the inside car temperature is located on the side of the car, thus making it unnecessary to open either the doors to the lading compartment or to the engine compartment to obtain inside temperature readings [Tr. p. 391]. The car functions as a cold storage facility [Tr. p. 397], designed to hold commodities at frozen temperatures, but not designed to freeze unfrozen commodities in transit [Tr. p. 400]. Appellee's refrigeration expert testified that Appellant's freezing practices were not entirely sound [Tr. pp. 404-407]. Best practice would be to freeze individual packages before they are bunched together, which Appellant did not do. Too much exposure to air temperatures between plant and rail car resulted in trucking one mile in unrefrigerated trucks and by not using a shroud. The high temperature in Culver City on July 21, 1960, was 92° [Ex. 10].

Appellee's expert conducted a test with "Poor Boy" sandwiches, similar to those involved in this suit. He reduced the product to zero degrees, inserted one thermometer into the bread and one into the meat while the sandwiches were still inside the carton, still wrapped in foil. He removed them to room temperature at about 70° and discovered that at the end of 30 minutes the meat temperature had risen 10° and the bread 20°. After the end of one hour, the meat had risen 10° and the bread 26°. At the end of four hours, the meat had risen to 44° and the bread to 56°. At the end of one and one-half hours, the approximate time the involved shipment was out of the freezer before loading into the rail car, Appellee's expert found that the meat had risen to 14° and the bread to 32° [Tr. pp. 407-409].

If the refrigeration system of the car had failed, the periphery of the load would be the first to warm up [Tr. pp. 411-412]. The Bureau Inspector at Chicago found no warm sandwiches in the periphery [Tr. p. 341].

Appellee's refrigeration expert analyzed the seven inspection reports [Ex. "C" to "I", incl] containing the temperature readings taken in transit, the fuel consumption, the operation of the equipment, and he concluded from said records that the equipment was operating satisfactorily for the entire trip [Tr. pp. 414-415].

There was more than adequate evidence to support Findings VII, VIII and IX.

II.

The Province of This Court Requires Upholding the Findings of the District Court.

(a) Appellant Wants This Court to Reweigh the Evidence.

Appellant makes no complaint of any error in the admission or exclusion of any evidence tendered by either side, and he complains of no irregularity at the trial. Appellant simply feels the District Court reached the wrong decision, and would have this Court review all the evidence, weigh it and judge of its credibility, and then review Findings VII, VIII and IX, because they "are so clearly against the weight of all of the evidence. . . ." (Appellant's Br p. 10). Although in the specification of errors Appellant states that in general the findings are erroneous as against law, in his argument that follows it is clear that his complaint is that not only the aforementioned findings, but also the findings in general are against the evidence.

(b) Federal Appellate Courts Are Required to Accept Findings if Not Clearly Erroneous and if Supported by Substantial Evidence.

Rule 52(a), Federal Rules of Civil Procedure, 28 U. S. C. A. provides that in an action tried to the Court the findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.

It is well established that Appellate Courts are required to accept findings of fact if supported by substantial evidence and not clearly erroneous.

Federal Security Insurance Co. v. Smith (10th Cir., 1958), 259 F. 2d 294;

Wunderlich v. United States (10th Cir., 1957), 240 F. 2d 201; cert. den. 353 U. S. 950, 77 S. Ct. 861, 1 L. Ed. 2d 859.

Substantial evidence means more than a mere scintilla and is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.

Consolidated Edison Co. v. National Labor Relations Board, 305 U. S. 197, 59 S. Ct. 206, 83 L. Ed. 126.

On appeal the evidence is to be viewed in the light most favorable to the prevailing party.

Lindsey v. Oregon-Washington Plywood Co. (10th Cir., 1961), 287 F. 2d 710.

Appellate Courts may not substitute their judgment if conflicting inferences may be drawn from the established facts by reasonable men, and the inferences drawn by the trial court are those which could have been drawn by reasonable men.

Timken Roller Bearing Co. v. United States, 341 U. S. 593, 596-597, 71 S. Ct. 971, 95 L. Ed. 1199.

This is particularly true where fact issues are not decided on written evidence alone, but the credibility of witnesses is involved, as is the case here. Rule 52(a) has recently been held to apply even when the trial court has not had the opportunity to judge the credibility of witnesses.

Lundgren v. Freeman (9th Cir., 1962), 307 F. 2d 104.

III.

No Error Was Committed by the District Court in Finding That Appellant Failed in Sustaining Burden of Proof That Appellee Was in Any Way Negligent (Finding X).

After Appellant offered evidence that the sandwiches were tendered to Appellee in a froxen condition, the burden of going forward shifted to Appellee, who showed that it complied with all requirements of the bill of lading and tariffs, transported with reasonable dispatch, exercised due care, and was completely free from negligence. It was Appellee's theory at the trial, which theory was adopted by the District Court in Finding X, that the burden of going forward with the evidence to show some specific negligent conduct on the part of the carriers then shifted back to Appellant. It is obvious that Appellant also recognized this burden, for in rebuttal Appellant called a consulting engineer, who was an expert in the field of refrigeration and air conditioning [Tr. pp. 509-511]. He testified with respect to certain hypothetical conditions that might have caused a failure in the refrigeration equipment in transit. He stated there might have been the possibility of failure of the air flow, or the possibility that the fan had a tight bearing. "This kind of thing can happen. I don't want to put any probability on it." Also, he thought there was a possibility of the failure of the interlock mechanism [Tr. p. 527]. Further, "I think we can say a possibility exists that any one of these failures which we have mentioned might have corrected themselves . . ." [Tr. p. 528].

This type of evidence was pure conjecture and surmise and was not sufficient to overcome Appellee's proof. The District Court so found in Finding X.

IV.

The District Court Did Not Predicate the Judgment on an Erroneous Interpretation of the Law.

(a) Burden of Proof on Shipper Throughout.

Under Point 1 of Appellant's Brief, pages 11 to 17, it is argued that Appellant had no duty to establish some specific act of negligence on the part of the carriers as a condition precedent to recovery, particularly since Appellee did not explain the true cause of the damage.

Under Point 2 of Appellant's Brief, pages 17 to 20, it is urged that the case was decided below upon an erroneous interpretation of the law as to burden of proof. The questions as to duty to establish negligence and as to burden of proof are so mixed and interdependent, they will be considered and answered together under Appellee's Point IV.

In the first place, it is not conceded that the true cause was not proved, for under the facts it could very well be concluded that the loss was proximately caused by the shipper in not tendering to the carrier a properly frozen shipment. A bill of lading Section 1(b) exception (act or default of the shipper) would therefore be available.

In the second place, the Carmack Amendment to the Interstate Commerce Act, 48 U. S. C. A. 20(11), as interpreted by Federal cases, does not require the carrier to prove the specific cause. All that is necessary to a successful defense of perishable commodity cases, governed by Tariff rules 130 and 135, is a showing by the carrier that it complied with instructions of shipper, the provisions of the bill of lading and tariffs,

and that it met its duty of furnishing, without negligence, reasonable protective service.

It is clear that in this type of case the burden of proof is on the shipper throughout. In *Chesapeake and Ohio R. Co. v. A. F. Thompson Mfg. Co.,* 270 U. S. 416, 422-423, 46 S. Ct. 318, 70 L. Ed. 659, it was held that in a suit under the Carmack Amendment, the burden of proof is on the plaintiff. When he introduces evidence of delivery of a shipment to a carrier in good condition, he makes out a *prima facie* case of negligence. However, when a railroad introduces evidence of the condition of the car from the time of shipment to the time of arrival at destination, it persuasively tends to preclude the possibility of negligence. If the proof ends there, the issue must as a matter of law be decided in favor of the carrier. As stated by the Court:

> "The respondent (shipper) therefore had the burden of proving the carrier's negligence as one of the facts essential to recovery. When he introduced evidence to show delivery of the shipment to the carrier in good condition and its delivery to the consignee in bad condition, the petitioner (railroad) became subject to the rule applicable to all bailees, that such evidence makes out a prima facie case of negligence. (Citing cases). The effect of the respondent's (shipper's) evidence was, we think, to make a prima facie case for the jury. (Citing cases). But even if this 'prima facie case' be regarded as sufficient, in the absence of rebutting evidence, to entitle the plaintiff to a verdict (citing cases), the trial court

> erred here in deciding the issue of negligence in favor of the plaintiff as a matter of law. For the petitioner (railroad) introduced evidence of the condition of the cars from the time of shipment to the time of arrival, which persuasively tended to exclude the possibility of negligence."

The burden of proof never shifts and if the carrier presents evidence sufficient to raise doubts as to the validity of the inference of negligence raised by the shipper's evidence, which the trier of fact is unable to resolve, the shipper does not sustain his burden unless he proves some specific negligent conduct on the part of the carrier that proximately caused the loss.

> *Commercial Molasses Corp. v. N. Y. Tank Barge Corp.*, 314 U. S. 104, 62 S. Ct. 156, 86 L. Ed. 89.

(b) A Successful Defense Is Established by Proof of Compliance and Exercise of Ordinary Care, Unless Shipper Shows, in Rebuttal, Specific Acts of Negligence.

The general principles of these two Supreme Court cases have been applied many times by various Courts of Appeal and District Courts. That this is the rule in this Circuit, is demonstrated in *Hamilton Foods, Inc. v. Atchison, Topeka & Santa Fe Ry. Co.*, 83 F. Supp. 478, affirmed (9 Cir., 1949) 173 F. 2d 573:

> "When proof is given by the plaintiff that property delivered to a common carrier in good condition was damaged while in the hands of the common carrier, a presumption arises that the damage was due to negligence and the burden of proof is upon it to show that it was free from negligence

or that notwithstanding its negligence the damage occurred without its fault—that is, the negligence did not contribute to the damage.

"The rule of perishable protective tariff approved by the Interstate Commerce Commission, is that if the goods arrive at the place of delivery in bad condition which was caused by lack of ordinary care on the part of the carrier, it is liable; *but a compliance with it is a defense against a charge of negligence. In other words, the measure of the duty of the carrier was to use reasonable, ordinary diligence. Under the protective tariff application shippers of perishable property must show that there was a lack of ordinary care on the part of the carrier.*" (Emphasis added.)

This is also the rule in the 5th Circuit, as stated in *Atlantic Coast Line R. Co. v. Georgia Packing Co.* (5 Cir., 1947), 164 F. 2d 1, 4:

"Under the protective tariffs applicable in this case the shipper must show that there was a lack of ordinary care on the part of the carrier, *but proof by the carrier of compliance with the shipper's instructions is a complete defense to an allegation of negligence in connection with the protective service.* Sutton v. Minneapolis & St. L. R. Co., 222 Minn. 233, 23 N.W. 2d 561; Southern Pacific Co. v. Itule, 51 Ariz. 25, 74 P. 2d 38, 115 A.L.R. 1274. *Plaintiff did not in any degree sustain its burden of proving the specific acts of negligence charged, while defendant-appellant incontrovertibly showed more than full compliance with plaintiff's instructions.*" (Emphasis added.)

Another case in the 5th Circuit following this rule is *Austin v. Seaboard Air Line R. Co.* (5 Cir., 1951), 188 F. 2d 239, 241:

> "Here, it was shown that the trees were loaded by plaintiff, and that an inspection was made by him before delivery of the shipment to the initial carrier. The box car furnished was in good condition, and was the type air-tight car ordered by plaintiff. Moreover, it is without dispute than after loading, the car was sealed, and that the shipment arrived at its destination with the seals unbroken. The evidence conclusively reveals that there was no unreasonable delay in the delivery of the shipment. Under such circumstances, the proof is more than adequate to overcome any inference of negligence on the part of the carrier, and the loss of the shipment must therefore be borne by the shipper. Chesapeake & O. R. Co. v. A. F. Thompson Mfg. Co., 270 U. S. 416, 423, 46 S. Ct. 318, 70 L. Ed. 659; see also, Atlantic Coast Line R. Co. v. Georgia Packing Co., 5 Cir. 165 F. 2d 169, 170."

This is also the rule of the 6th Circuit, as stated in *Delphi Frosted Foods Corp. v. Illinois Central R. Co.*, 89 F. Supp. 55, 60, affirmed (6 Cir., 1951), 188 F. 2d 343:

> "The evidence introduced by defendant is not only sufficient to raise an unresolvable doubt as to the validity of the inference of negligence arising from the prima facie case made by the plaintiff's proof but it is amply sufficient to persuade that non-existence of negligence in the performance

> of the duty to afford reasonable protective service of the kind and extent requested by the shipper is as probable as its existence. The plaintiff has not sustained the burden of persuasion which upon the whole evidence remains upon it, where it rested at the start."

Appellant places great reliance on *Thompson v. James G. McCarrick Co.* (5 Cir., 1953), 205 F. 2d 897, where it is stated (at p. 900) that after the shipper's *prima facie* case "the burden shifts to the carrier to show the cause of damage and that it is not liable therefor." This was a wholly gratuitous statement on the part of the Court for the only issue in the case was whether as a condition precedent to recovery a timely claim in writing had been filed. It is interesting to note that the Fifth Circuit Court of Appeals never referred to its prior decisions in the *Georgia Packing Co.* or the *Austin* cases, *supra,* where it was an issue as to whether proof by the carrier of compliance with instructions would constitute a defense, in the absence of rebuttal evidence by the shipper showing the specific cause.

The rule contended for by Appellee is also the rule in the 7th Circuit where in the case of *Hamilton Manufacturing Company v. Chicago and North Western Railway Company* (7 Cir., 1960), 277 F. 2d 652, after the carrier had shown it was free from negligence and had handled the shipment pursuant to shipper's instructions, the Court held:

> "The burden was on the plaintiff to establish that some negligence of the defendant carrier concurred in or contributed to the damage. No such proof was made and under the circumstances dis-

closed by the record the defendant was entitled to appropriate findings of fact, conclusions of law and judgment dismissing the complaint without costs."

This is also the rule in the 4th Circuit, as set forth in *South Carolina Asparagus Growers' Assn. v. Southern Ry. Co.* (4 Cir., 1931), 46 F. 2d 452, where Court held that in defending the suit the carrier showed by conclusive evidence that the car was transported with all due dispatch and was properly iced at all points where icing was necessary and, hence, was entitled to judgment.

This is also the rule in the District of Columbia Circuit. *Shapiro v. Pennsylvania R. Co.* (D. C. Cir., 1936), 83 F. 2d 581, was an action to recover damages against a railroad for failure to safely refrigerate a shipment of vegetables. The case was defended on basis that the car was iced at all regular icing stations and was in good mechanical condition. Judgment for the defendant was affirmed because (a) a carrier is not an insurer of perishable shipments, (b) the defendant had fully discharged every duty owing by it to the plaintiff, (c) the damage was therefore caused as a result of the inherent vice of the things shipped.

Lastly, this is the rule in the Southern District of New York, as set forth in *Standard Hotel Supply Co. v. Pennsylvania R. Co.,* 65 F. Supp. 439, where the Court held for the defendant carrier upon a showing that it had complied with the icing instructions as directed by the shipper. The Court held:

"The defendant railroad furnished reasonable protective service, of the kind and extent requested

> and directed by the plaintiff shipper under Tariff Rules 130 and 135; the loss was caused by the acts of the shipper, for which the railroad is not responsible. Shapiro v. Pennsylvania R. Co., 65 App. D.C. 324, 83 F. 2d 581; South Carolina Asparagus Growers Association v. Southern R., 4 Cir., 46 F. 2d 452; Leonard v. Pennsylvania R. Co., D. C., 15 F. Supp. 55, 56."

The decision in *Daido Line v. Thomas P. Gonzalez Corporation* (9 Cir., 1962), 299 F. 2d 669, upon which Appellant relies so heavily, is not contrary to the rule on burden of proof contended for by Appellee. This Court there recognized that (page 671):

> ". . . the attempt to establish liability by a step-by-step progression through the accepted scheme of shifting burdens of proof may present difficult problems."

But no such problems were presented in the case at bar. It is important to remember that in the *Daido Line* case, the shipper's bill of lading instructions to the carrier were to afford the shipment "ventilated stowage." It is not clear from the decision at what stage of the trial it was proved to the satisfaction of the Court that the carrier did not provide "ventilated stowage." It is submitted that at what stage or in what order of proof this evidence was adduced is wholly immaterial, for the Court found that the carrier did not provide "ventilated stowage" and that this act or omission constituted a failure to exercise reasonable care. The shifting burdens therefore presented no problem. It mat-

tered not whether the evidence on ventilation came in at the time the carrier was attempting to prove compliance with instructions and to prove the exercise of ordinary care, or whether it came in during plaintiff's rebuttal, for the specific act of negligence was proven not by conjecture or surmise, but by direct testimony of two of the ship's officers and from entries in the ship's log. With such a poor record of handling the shipment, it is difficult to ascertain why the case was defended at all. It is not out of line with the position Appellee takes here, but on the contrary supports Appellee's view that Appellant must prove a specific act of negligence in order to recover.

At page 675, the Court held:

> "On this evidence it was entirely reasonable for the District Court to conclude that the garlic was outturned in a damaged condition and that the events aboard ship provided an ample explanation for the condition in which the garlic was discharged, thus offering further support for the conclusion that the garlic was delivered to the vessel in good order and condition."

Conversely, in the case at bar, evidence as to the participating carriers' handling of the shipment from origin to destination offers ample support for the conclusion that the sandwiches were not delivered to the Appellee in good order and condition or that their loss was occasioned by inherent vice or defect, a condition to which all perishable shipments are subject.

The case of *Southern Pacific Co. v. Itule,* 51 Ariz. 25, 74 P. 2d 38, 115 A. L. R. 1268, succinctly answers Appellant's contention. That decision traces the development of the rule, showing its evolution from the rule applicable to loss and damage of inanimate or "dry" freight shipments, the rule pertaining to livestock, and finally a discussion as to the quantum of proof necessary in a perishable commodity case. The Arizona Court announces with clarity the rule adopted by it and by the Federal Courts:

> "We think the fairer and more logical rule is that in cases of the shipment of perishable fruits and vegetables, when the carrier shows affirmatively that it handled them in the method requested by the shipper, and that it exercised reasonable care to prevent any damage from any cause not necessarily involved in the method of transportation so chosen, that it has satisfied the requirements of the law in regard to the quantum of proof required to establish a defense to the action."

The record amply reflects the proper application of the law by the Court below, both as to duty and as to burden of proof. There is no requirement in the Act or in the case law that the carrier must establish the actual cause of the damage. The reason for this rule is that in cases of this kind, where perishable shipments are prepared, packaged and loaded solely by the shipper, the carrier does not know, nor does it have any means of ascertaining the condition of the shipment at the time it accepted it from the shipper. Be-

cause the shipper has sole control over these matters, only the shipper knows of the condition of his shipment. It is the shipper, therefore, not the carrier, who is in the best position to explain the cause of the loss. If he fails to meet this proof in rebuttal to the carrier's proof, he has left the trier of the facts, as he did here, with an "unresolvable doubt."

Commercial Molasses Corp. v. N. Y. Tank Barge Co., 314 U. S. 104, 111, 62 S. Ct. 156, 161, 86 L. Ed. 89;

Delphi Frosted Foods Corp. v. Illinois Central, 89 F. Supp. 55, 60, affirmed (6 Cir., 1951), 188 F. 2d 343.

Secretary of Agriculture v. United States (1956), 350 U. S. 162, 76 S. Ct. 244, 100 L. Ed. 173, is not applicable to the facts in the case at bar. That case involved the validity of tariff tolerance provisions respecting damage to shell eggs and was not an adversary proceeding between shipper and carrier. The sole issue was whether there was sufficient evidence before the Interstate Commerce Commission to support its order approving the filing of said tariffs. Some general propositions of law are discussed in the majority, concurring and dissenting opinions, but no consideration was given to the questions of duty to prove negligence or burden of proof under Tariff rules 130 and 135. There is nothing in that case that calls for a reversal here.

V.

The Findings Do Cover All Pertinent Issues and Hence Are Not Erroneous.

Under Point 3 of Appelant's Brief, pages 21 to 24, it is asserted that the findings are erroneous because all pertinent issues are not covered. Specifically, a complaint is lodged against (1) failure to find concerning the condition of the shipment at origin and (2) the cause of the damage.

As to condition of the shipment when tendered to the Appellee, it is submitted that the Court made the only finding possible to make under the state of the evidence. There was no clear showing by Appellant that all the sandwiches were in a frozen condition at Culver City. After what was observed at Chicago, it was fairly obvious that they were not—at least 5 to 10% were not. The Court could, therefore, make the only finding it could under the circumstances make, *i.e.,* that the parties agreed in the bill of lading that the sandwiches were in "apparent good order" [R. A. p. 43].

As to the cause of the damage, Appellee submits that under the authorities cited in Point IV herein, the law does not require the carrier to prove the cause of the damage in a *perishable shipment case* wherein Tariff Rules 130 and 135 are applicable. This is the preponderant Federal rule and is the rule of most state courts. See Annotation: Necessity of proving specific reason for injury or damage to shipment of fruit or vegetables in order to overcome *prima facie* case, etc., 115 A. L. R. 1274.

Formal findings of fact need not be made on evidence relating to redundant and immaterial issues.

> *Nuelsen v. Sorensen* (9 Cir., 1961), 293 F. 2d 454, 459.

VI.

No Error Was Committed in Finding That the Sandwiches Were Perishable.

Under Point 4 of Appellant's Brief, pages 25 to 30, inclusive, Appellant complains that the finding "Said sandwiches were in fact of a perishable nature" [R. A. p. 43, lines 15-16] is erroneous because it is contrary to uncontradicted evidence. This is not so because (a) at origin the parties agreed in the bill of lading [Ex. 4] that the condition of the contents of the 2316 cases of merchandise was unknown, (b) at destination, the sandwiches, or at least a portion thereof, were found to have in fact "perished", the inspectors for both parties agreeing that at least some were in an unfrozen and moldy condition, and (c) the finding makes no reference to "frozen" sandwiches but to "said sandwiches", some of which were unfrozen at destination and which, considering the whole evidence, were obviously in that state at origin.

Appellant had the difficult task of convincing the District Court that all the lading was tendered to Appellee in a frozen condition, when one case of sandwiches with pulp temperature of 64° was found in the core of the load at Chicago, completely surrounded by cases of sandwiches that were frozen solid. His task went from difficult to impossible when it was shown that at Chicago no unfrozen sandwiches were found in the periphery of the load. This is where one would expect to find unfrozen lading, if the refrigeration system had failed enroute, for the cold air circulates in air chambers, called flues, in the sides, end wall, top and in the floor of the car.

Appellant is arguing, in effect, that since a frozen commodity is inert, the law of freight loss and damages applicable to inanimate or dry freight should apply, *i.e.,* that if the carrier cannot prove a bill of lading Section 1(b) exception, it should not prevail. Appellant's argument is aimed at removing the case from the provisions of Rules 130 and 135.

Delphi Frosted Foods v. Illinois Central R. Co., 89 F. Supp. 55, aff. (6 Cir., 1951), 188 F. 2d 343, is a specific example of a case holding that frozen lading is perishable within the meaning of Tariff rules 130 and 135.

No contention was made in the trial of the case at bar the Rules 130 and 135 did not apply, and copies thereof were received in evidence without objection. Appellant had ample notice that Appellee would rely on the provisions of said rules, inasmuch as they were pleaded in its answer [R. A. pp. 9-10].

Conclusion.

The Appellee is not responsible as at common law for the loss of or damage to this shipment. It is responsible only for carrying out the Appellant's orders under Rules 130 and 135 of the Perishable Protective Tariff. These rules, being published in a tariff filed with and approved by the Interstate Commerce Commission, have the force and effect of law and constitute a statutory form of contract between the parties.

The evidence is virtually uncontradicted that Appellee carried out the instructions, which were to furnish mechanical refrigerated service to safeguard a shipment tendered as frozen. The shipment was enroute

six days and the temperature of the lading compartment of the car was recorded seven times, the highest observed being +7°. Appellant was satisfied that a sandwich was frozen if reduced to a temperature below 28°.

There was ample evidence to support all the District Court's findings and the judgment should, therefore, be affirmed.

Dated: March 8, 1963.

Respectfully submitted,

E. D. Yeomans,
Walt A. Steiger,
Attorneys for Appellee.

Certificate.

I certify that, in connection with this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Walt A. Steiger
Attorney for Appellee.

No. 18265

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LARRY'S SANDWICHES, INC., a California corporation,

Appellant,

vs.

PACIFIC ELECTRIC RAILWAY CO., a California corporation,

Appellee.

Appeal from the United States District Court for the Southern District of California, Central Division.

REPLY BRIEF OF APPELLANT.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

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Appellee.

REPLY BRIEF OF APPELLANT.

Statement of the Case.

In its statement of the case Appellee characterizes the action as one founded on negligence and urges the primary issue in controversy on the appeal is the sufficiency of the evidence to support the District Court's finding that the Appellant failed to prove lack of due care on the part of Appellee. Appellant takes issue both with the characterization of the nature of the action and Appellee's statement as to the issues involved.

The action is founded upon the statutory duty of a common carrier to a shipper. That duty, in the absence of a showing of special circumstances, is that of an insurer. Only when these special circumstances are shown to exist does the carrier duty for care of goods

in transit shift to one of due care. As this Court has noted, in establishing liability there is a ". . . step by step progression through an accepted scheme of shifting burdens of proof . . ." (*Daido Line v. Thos. P. Gonzales Corp.,* 299 F. 2d 669, 671 (C. A. 9, 1962).) Appellant has specified five basic errors committed by the District Court. Four of these are based upon the proposition that the posture of the case in this step-by-step progression was such, both on the status of the proof and of the findings at the time of judgment, that Appellee's duty continued to be that of an insurer rather than one of due care. As a final specification of error Appellant urges that even if the test of due care is applicable the findings with respect thereto are so at variance with the clear weight of the evidence it is apparent a mistake has been made.[1]

Appellee's statement of the issues and of the nature of the action presume the final contention above noted is the only one before the Court for decision. Because the step-by-step progression through the accepted scheme of shifting burdens of proof must be followed to establish the nature of liability the specifications of error placing in issue the question of the posture of the case at the time of decision are the primary issues

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[1]Formal statement of the questions presented and the specifications of error appear in the Opening Brief at pages 7-10. Statements in the Reply Brief as to errors specified and questions involved are intended as a reference thereto and should not be construed as modifying or changing Appellant's position as there stated.

on the appeal and must all be resolved before the issue which Appellee declares to be the critical issue is reached. Actually, if the Court finds merit in any of the first four specifications of error the final contention as to the weight of the evidence on the issue of due care is never reached. Thus, the issue which Appellee considers as the critical issue is in reality a contingent issue.

Because the determination of legal duty depends upon the true posture of the case at the time of decision and this posture in turn must be evaluated in terms of the step-by-step progression of proof it is necessary, properly to respond to the arguments of Appellee in the Reply Brief, to consider the several specifications of error in the order set forth in the Opening Brief rather than in the order adopted by Appellee in its reply.

ARGUMENT.

1. The District Court Has Predicated Its Judgment Upon an Erroneous Interpretation of Law.

1.1. Résumé of Appellant's Position.

By statute a common carrier is liable without proof of negligence for all damage to goods while in transit unless the carrier can make an affirmative showing that the damage was occasioned by an Act of God, the public enemy, public authority, an act of the shipper or the inherent vice or nature of the commodity.

> *Secretary of Agriculture v. United States,* 350 U. S. 162, 165, 100 L. Ed. 173, 76 S. Ct. 244 (1956).

The duty to establish the existence of an excepted cause changing the character of its legal duty rests with the carrier.

> *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 (C. A. 9, 1962).

Even in those situations in which injury in transit is attributable to one of the excepted causes the carrier must still act with due care in light of the special circumstances with which it is presented.

> *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 (C. A. 9, 1962);
>
> *Firpine Products Co. v. A.T. & S.F. Railway Co.,* 124 F. Supp. 906 (1954).

By the phraseology used in its findings [R. A. 43-44], and by its refusal to make findings on the question of the condition of the goods at the time of tender and upon the question of the presence or absence

of an "excepted cause" as a contributing factor to the injury after request therefor [R. A. 47, 108] the District Court made it clear that its concept of the law was that the carrier had at all times a duty of due care only and that it was the responsibility of Appellant to establish some specific negligent conduct as a condition precedent to a right of recovery.

1.2. Appellee Fails to Meet the Issue Presented on Appellant's First Specification of Error.

Appellee predicates its reply to the first specification of error upon two propositions:

(1) That all that is necessary for a successful defense of a "perishable commodity" case is a showing by the carrier that it complied with instructions, the provisions of the bill of lading and tariffs, and that it furnished, without negligence, reasonable protective service;

(2) That there is allegedly some evidence of record from which it might have been concluded that the loss was proximately caused by the shipper in not tendering to the carrier a properly frozen shipment. Both of these propositions beg the question in issue.

All that Appellee says by its argument is that the District Court applied a test of due care and that this test is the applicable test if all necessary conditions precedent in the step-by-step progression for determining carrier liability have been met. The test of due care is, however, a test applied in many situations. It is the motivation for the use of the test and not the fact of its use which is the significant circumstance in the determination of the issue here under consideration.

The District Court found that the sandwiches constituting the shipment were in fact of ". . . a perishable nature . . ." [R. A. 43.] It did not, however, make a finding that the damage was in fact caused by any inherent vice in the goods. No finding was made as to the condition of the goods at the time it was tendered to the carrier or that any act of the shipper contributed to the injury. These omissions must be accepted as intentional since the District Court denied Appellant's request that findings be made upon these issues after extensive points and authorities had been filed, a transcript of the record made available and oral argument had been presented. [R. A. 47-49, 51-60, 62-71, 73-93, 95-106, 108.] The refusal of the District Court to concern itself with whether or not the injuries were generated by some one or more of the "excepted causes"—the most important single element in the step-by-step progression for determining the character of the carrier liability—is a clear indication that it was not applying the applicable law to its determination of the case.

None of the cases cited by Appellee at pages 19 through 27 of its Brief is authority for the application of a test of due care to carrier responsibility for shipments in transit absent a precedent determination that the injury thereto was occasioned by an Act of God, the public enemy, public authority, the shipper or the inherent vice or nature of the commodity. In each of the cases so cited in which the test of negligence was applied the existence of an inherent vice or natural condition of the product was admitted to be or specifically found to be the immediate cause of the product deterioration. In the case of *Delphi Frosted Foods*

Corp. v. Illinois Central R. Co., 188 F. 2d 343 (C. A. 6, 1951), the only case cited involving frozen products, there is a discussion as to when the rule of negligence is to be applied. However, in that case the actual basis of decision was that the merchandise was not in good condition when tendered for transportation and that no damage occurred in transit.

Several of the cases cited by Appellee, including *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 decided by this Court in 1962, are authority for the proposition urged by Appellant that the carrier is burdened with proving that product involved suffered from an inherent defect as a condition precedent to a right to have its conduct with respect to the shipment measured by a standard of due care. Thus the refusal of the District Court here to consider and pass upon the existence or non-existence of an "excepted cause" of the loss is thus confirmed by Appellee's own authorities as a failure to apply the pertinent law.

2. The District Court Has Incorrectly Interpreted the Law as to Burden of Proof.

2.1. Résumé of Appellant's Position.

By its Findings of Fact the District Court imposed upon Appellant the burden of proving some specific act or omission constituting negligence on the part of Appellee or its connecting lines as a condition of Appellant's right to recover in the action. [R. A. 44.] There is a series of conditions precedent shifting burdens of proof which must be found to prevail before the burden imposed by the District Court falls lawfully upon the Appellant. These conditions precedent include the determination that the injury in fact occurred while the

goods was in transit, a determination that inherent vice, some act of the shipper or some other of the "excepted causes" has occasioned some injury to the goods while in transit, and that the carrier has made a *prima facie* showing that it has been free from negligence which would add to an injury otherwise beyond its power to control. In the present case the District Court has ignored all of the conditions precedent to the applicability of the rule as to burden of proof which it has applied, with the possible exception of the *prima facie* showing of the carrier. Since the District Court has refused to make findings as to the condition of the goods at the time of tender and as to the presence or absence of one of the "excepted causes" as a contributing factor to the damage sustained the posture of the case was such at the time of decision that it was improper under the applicable law to impose upon the Appellant the burden of proof fixed in Finding of Fact X.

The Daido Line v. Thomas P. Gonzales Corp., 299 F. 2d 669 (C. A. 9, 1962).

2.2. Appellee Presents No Arguments Sustaining the Position of the District Court as to the Burden of Proof Imposed Upon Appellant.

Appellee has combined in its reply its arguments with respect to Appellant's contentions 1 and 2. Therefore, the comments in the next preceding part of the Reply Brief also constitute a reply to the contentions of Appellee here under consideration.

The principal vice in the argument of Appellee appearing at pages 18 through 27 of its Brief is that it

assumes the District Court resolved in Appellee's favor all issues which would make applicable the rules for which Appellee contends when in fact the District Court did not do so. In all of the cases cited by Appellee in which the burden of proof here imposed by the District Court was sustained, the Court had made all of the necessary antecedent findings in the ". . . step-by-step progression through the accepted scheme of shifting burdens of proof . . ." so that the case was clearly in a proper posture at the time of decision for the application of the rules as to burden of proof applied. Here the District Court refused to make findings as to the condition of the goods at time of tender or as to whether or not an act of the shipper or inherent vice contributed to the loss sustained. Appellee's argument assumes, without justification, that these findings, if they had been made, would all have been resolved in Appellee's favor. What findings the District Court would have made had it undertaken to resolve these issues is, at this juncture, a matter simply of speculation. The fact that the District Court refused to find on these antecedent issues does show, however, that it was not applying the rules announced in the cases cited by Appellee (and by Appellant) in arriving at its decision as to the burden of proof which it felt Appellant was required to bear.

Appellee urges that where "perishable shipments" are involved and the shipper has packaged and loaded the goods the burden is on the shipper to show the condition

of his shipment. In the argument Appellee fails, as did the District Court, to take cognizance of the step-by-step progression necessary in a case of this type.

The shipper does have the burden of proving that the shipment was in good order when tendered to the carrier for transportation.

> *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 (1962);
>
> *Thompson v. James G. McGarrick Co.,* 205 F. 2d 897 (C. A. 9, 1953).

When the goods is packaged and loaded by the shipper this burden is not met by the presumption of a so-called "clear" bill of lading and proof must be presented the shipment was in fact in good order when received by the carrier.

See:

> *Armour Research Foundation v. Chicago R.I. & P. Co.* 297 F. 2d 176 (C. A. 7, 1961.)

However, this burden of proof as to good order at time of tender is a burden imposed on the shipper to establish that the injury in fact took place while the goods was in transit and not at some prior or later time. The rule is clear that once it is shown that the injury occurred while the shipment was in transit the carrier must show that the loss was attributable to an excepted peril.

> *Schnell v. The Steamship Vallescura,* 293 U. S. 296, 79 L. Ed. 373, 55 S. Ct. 194 (1934);
>
> *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 (C. A. 9, 1962).

The Supreme Court in the *Schnell* case stated the rule and the reason therefor as follows:

> "He [the carrier] is a bailee entrusted with the shipper's goods, with respect to the care and safe delivery of which the law imposes upon him an extraordinary duty. Discharge of the duty is peculiarly within his control. All the facts and circumstances upon which he may rely to relieve him of that duty are peculiarly within his knowledge and usually unknown to the shipper. *In consequence, the law casts upon him the burden of the loss which he cannot explain, or explaining, bring within the exceptional case in which he is relieved from liability.*" (p. 304; emphasis added.)

The record in this case shows without contradiction that it would be a physical impossibility for a frozen shipment in a properly operating car of the type used to arrive at destination in the condition which was actually found to exist. [Tr. 308, 399.] Since the District Court has refused to find either as to the condition of the goods at the time of tender or as to possibility of the intervention of an excepted peril the cause of the loss remains "unexplained". Thus on the state of the record at the time of decision and judgment conditions had not been established, under applicable law, imposing upon Appellant the burden which the District Court in fact used in its determination of the case.

3. The Findings of Fact Are so Incomplete and Indefinite That Clear Understanding of the Basis of Decision Is Impossible.

3.1. Résumé of Appellant's Position.

As has been noted, the District Court refused to make findings as to the actual condition of the shipment at the time of tender and as to whether or not some act of the shipper or an inherent vice in the goods was the generative cause of the damage suffered. These are pertinent issues as to which the District Court was obligated to make findings.

Fed. Rules Civ. Proc. 52(a);

Dale Benz, Inc. v. American Casualty Co., 303 F. 2d 80 (C. A. 9, 1962).

In the absence of findings on these pertinent issues it is impossible for the parties or for the Court of Appeals to ascertain with certainty what was the actual basis of the District Court's decision and judgment.

3.2. Appellee's Reply, in Effect, Concedes the Validity of Appellant's Contention That the Findings Are Deficient.

Appellee urges at page 28 of the Brief that the law does not require a carrier to prove the cause of damage in a ". . . perishable shipment case . . ." The argument misses the point. A "perishable shipment case" is simply a case in which it has been found that the commodity involved contains an inherent vice producing self destruction and that the injury is the result of the operation of this internal force. It is the absence of such a finding here which is the basis of Appellant's objection.

Appellee's basic liability as a carrier is that of an insurer so far as damage to goods in its custody for transportation is concerned.

> *Secretary of Agriculture v. United States,* 350 U. S. 162, 165, 100 L. Ed. 173, 76 S. Ct. 244 (1956).

To avoid that liability it was necessary for Appellee to establish two things: (1) that some act of Appellant or some inherent vice in the goods actually caused damage to the goods while it was in course of transit, and (2) that Appellee did not aggravate the injury by any lack of due care on its part.

> *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 (C. A. 9, 1962).

The argument of Appellee here under consideration is related to its duty in order to make a *prima facie* showing under the second circumstance above. The deficiency in findings as to which Appellant complains relates to the first. Obviously, there must first be a finding that an "excepted peril" caused injury before an issue can arise as to the character of Appellee's conduct in the face of such peril.

Appellee argues that the District Court made a finding that the shipment was tendered in "apparent good order" and that such finding is the only one which could have been made on the record before it. The District Court did not so find. Its finding in this respect simply was that the receipt issued by Appellee at the time the goods was received stated that the shipment was in "apparent good order" when received. A considerable portion of the testimony at the trial was devoted to the subject of the actual condition of the

goods at the time of tender to Appellee. A finding of some kind as to the proof with respect to the condition of the goods at time of tender was necessary. Appellant believes the state of the record is such that the District Court was compelled to find either that the shipment was in good order or that it was not. At the very least the District Court was required to find that there was insufficient evidence to establish condition at the time of tender. Had such finding been made this Court and the parties would at least know that the District Court had predicated its judgment upon a determination that an injury *while the shipment was in transit* had not been proved. The difficulty is that there is a complete absence of any finding on this fact issue upon which every other fact issue in the case depends to a greater or lesser degree.

As the briefs of both parties show, on each question which is raised and in each argument which is presented with respect thereto it has been necessary to speculate as to what was in fact the position of the District Court on ultimate facts vital to a proper determination of the controversy. In such a situation the Court of Appeals lacks the information required for an intelligent review of the lower court's judgment.

National Lead Co. v. Western Lead Products Co., 291 F. 2d 447, 451 (C. A. 9, 1961);

Irish v. United States, 225 F. 2d 3 (C. A. 9, 1955).

4. The Finding That the Sandwiches Were "Perishable" Is Clearly Erroneous.

4.1. Résumé of Appellant's Position.

The only finding made by the District Court which could possibly be construed as related to the subject of an "excepted peril" is the statement in Finding of Fact V that "Said sandwiches were in fact of a perishable nature." [R. A. 43.] In the context of the issues of the present litigation the statement is ambiguous. All products are "perishable" in the sense that they can be destroyed by some outside force. Some articles are also "perishable" in the sense that they have an inherent power of partial or total self-destruction while in transit even though every reasonable precaution against such destruction is taken by the carrier.

A carrier is liable without negligence for destruction of goods in its custody by the intervention of some exterior force.

> *Secretary of Agriculture v. United States,* 350 U. S. 162, 100 L. Ed. 173, 76 S. Ct. 244 (1956).

There is no responsibility upon the carrier for a loss in transit attributable entirely to the operations of a self-destructive force inherent in the character of the article itself.

> *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 (C. A. 9, 1962).

A carrier is, however, liable if the self-destructive processes have been accelerated beyond their normal rate during transit because of some lack of due care on the carrier's part.

> *The Daido Line v. Thomas P. Gonzales Corp.,* 299 F. 2d 669 (C. A. 9, 1962).

The commodity shipped consisted of "frozen sandwiches". The vehicle of transportation was a mechanically refrigerated car. Frozen sandwiches are inert and have no inherent vice or other natural power of self destruction so long as they remain "frozen sandwiches". The function of a mechanically refrigerated car is to prevent the destructive force of heat from an outside source from reaching and damaging the product while in transit. Measurable deterioration of frozen sandwiches in a properly operating refrigerator car during the transit times involved in the present case is shown by the uncontradicted evidence of both parties to be a physical impossibility. A finding that the sandwiches in their frozen state are a "perishable" in the legal sense of that term pertinent to the present litigation is, therefore, clearly erroneous.

4.2. Appellee Has Failed to Demonstrate That Frozen Sandwiches Are Subject to Any Inherent Vice or Other Natural Condition Which Could Cause the Damage Sustained.

As has been noted in the Opening Brief, expert testimony as to the physical characteristics of the product and the rail car involved was presented by both parties. (Op. Br. pp. 27-29.) Appellee's own expert witness explained that there is a difference between what he described as "fresh perishables" and "frozen commodities". [Tr. 399.] Fresh perishables have a "heat of respiration" which may be as much as several times the heat which would leak through the wall of the storage structure. [Tr. 399-400.] Fresh food products are, therefore, subject to a self-generated heat, producing decay which is at work at all times. It is this self-

generated heat which is the "inherent vice" bringing food products within the rule of "excepted perils" for purpose of determining carrier liability.

The products here involved were not fresh but frozen. The uncontradicted testimony of the expert witnesses produced by both parties establishes that frozen sandwiches are inert so far as heat generation is concerned. [Tr. 399, 208.] Held below their freezing temperature sandwiches will keep without deterioration for as much as a year or more. [Tr. 209.] The mechanically refrigerated car provided for transportation of the shipment involved had the design capability of holding the sandwiches in a frozen condition. [Tr. 441-445, 521-523.] The only source of heat capable of causing decay to a frozen product in such a car would be that introduced through the wall or car structure. [Tr. 399.] In short, on the evidence of Appellee's own expert, frozen sandwiches are not the subject of any "inherent vice or natural condition" of such character as to bring them within the scope of the "excepted perils" rules.

The only evidence to which Appellee makes reference in support of the District Court's finding that the sandwiches were "perishable" is the testimony given by a claims inspector as to an examination made by him of the damaged merchandise the day following the first discovery of the damage and after a part of the load had been removed and replaced. [Tr. 157, 327-330.] The testimony to which Appellee refers is to the effect that cases of sandwiches at 64° Farenheit were found completely surrounded by cases of sandwiches which were frozen solid in an area of the car where the load had presumably not been disturbed. [Tr. 356.] More

will be said in the next part of the Reply Brief as to the incredibility of this evidence. It is sufficient here to note that the refrigeration experts called by both parties were in agreement that what the witness Hailey said he found as to the temperatures of adjacent packages is a physical impossibility under natural laws of heat transfer. [Tr. 417, 534.] However, assuming the testimony of the witness Hailey could be believed, it would not establish that frozen sandwiches are the subject of any inherent vice capable of their self-destruction. The evidence does not, therefore, provide support for the finding of the District Court here under consideration.

Appellee cites *Delphi Frosted Foods v. Illinois Central R. Co.,* 89 F. Supp. 55, aff. (6 Cir. 1951), 188 F. 2d 343, apparently for the proposition that frozen foods are subject to an inherent vice or natural condition as a matter of law. The question of "inherent vice" is one of fact in each case and not a matter of law. Actually, the *Delphi* case does not consider the question here raised. The basis of decision in the cited case was that the shipment was not in fact frozen when tendered for transportation. Further, the refrigeration provided in that case was the traditional ice and salt. Mr. McKee, Appellee's expert in the present case, testified ice and salt are not capable of creating temperatures low enough to maintain the frozen condition of a commodity during normal transit conditions. [Tr. 376-377.] The car used in this case was designed to have such a capability. Thus, in the *Delphi* case temperature rise of the product was apparently an anticipated circumstance of the transportation. In this

case it was not a circumstance to be considered on Appellee's premise as to the facilities it provided.

The fact that Appellee's tariff Rules 130 and 135 were received in evidence without objection cannot be taken as proof that the shipment was subject to an "inherent vice". At all stages in the proceeding there has been an issue as to whether the damage was caused in act by an inherent vice or defect in the product shipped [R A. 26.] The rules to which Appellee makes reference simply declare in tariff form the statutory duty of the Appellee existing as to products shown to have some inherent vice or natural condition producing self-destruction during transit. The rules have some pertinence to the case if Appellee could establish by other evidence the product had an inherent tendency to decay in the transportation environment Appellee agreed to provide. The tariff rules could not, however, establish the physical characteristics of the frozen sandwiches.

5. The Findings of the District Court That Appellee Did Nothing to Cause Damage to the Shipment and That It Acted in Compliance With the Bill of Lading and Applicable Tariffs Are Clearly Erroneous.

5.1. Résumé of Appellant's Position.

It is Appellant's position that even though all other issues on appeal were to be resolved in favor of the Appellee reversal is here required because the findings as to the cause of damage are clearly erroneous within the meaning of Federal Rules of Civil Procedure, Rule 52(a) as interpreted in *United States v. U. S. Gypsum Co.*, 333 U. S. 364, 92 L. Ed. 746, 68 S. Ct. 525 (1947). The evidence is uncontradicted that the Appellant pre-

pared and loaded the product for transportation in accordance with accepted industry practices. Other loads had been similarly handled without incident. Those who participated in the loading process gave uncontradicted evidence establishing the shipment was frozen and otherwise in good condition when tendered to Appellee. In its frozen condition in a properly operated car the shipment was inert and incapable of self-destruction. Heat was necessary to produce the injury involved. The only possible source of such heat was improper leakage through the car structure. Such leakage could occur only if the car did not function properly. Physical evidence of condition of the shipment at destination and the history of recorded temperatures in transit are consistent with a malfunction in the air circulation system. Without air circulation heat leakage would be inevitable. Under the circumstances the injury must have resulted from a failure of Appellee's car to function as designed and Appellee has, therefore, been the actual cause of the injury involved.

5.2. The Evidence to Which Appellee Makes Reference in the Brief Does Not Support the Challenged Findings of the District Court.

To support the Findings that it was not the cause of the injury involved Appellee relies almost entirely upon evidence which it considers to be indicative that the shipment was not frozen when it was first tendered for transportation.

The evidence to which Appellee first directs attention is the record of thermometer readings taken while the car was in transit to Chicago. These readings were +7°, +5°, +6°, +2°, +6°, +8°. [Ex. A.] Appel-

lee's own expert conceded that this temperature pattern was not what would be expected to result in a car at a setting of −5° operating normally with a frozen load. [Tr. 459-462.] Temperatures ranging to +64° were found upon arrival. Appellee's expert inferred that the temperature pattern of car readings might be attributable to warm product. [Tr. 422.] However figures presented by the same witness indicate the car had the capacity to exert a cooling influence on the entire load even under such circumstances. [Tr. 443-445.] The record shows without question that on the return trip when it is known that there was product in the car at 64° and a properly operating car the temperature pattern of the thermometer readings shows a steady decline and much lower readings than those shown on the eastbound trip. [Ex. A.] The thermometer readings reflect only air temperature immediately below the freezer coils. [Tr. 525-526.] Those recorded while the car was in transit to Chicago are consistent with a malfunctioning of the air circulation system and a warming load but not consistent with a properly operating system and a cooling load. [Tr. 525-526.] All factors considered, it is apparent the temperatures in the car are not necessarily reflected by the gauge readings and that the readings are more indicative of malfunction than of proper function of the car.

Appellee makes some point in the Reply Brief that the merchandise was moved by truck in unrefrigerated vans the distance of approximately one mile and that "shrouds" were not placed over the car doors during loading. (Reply Br. p. 9.) Reference is made to certain experiments conducted by the Appellee's expert as

to the time for two sandwiches, in the customary paper container and foil, to thaw. Appellee argues, although its expert did not so testify, that similar conditions could be expected in the movement of the cartons in loading as were found to exist as to separate packages in the experiment.

If Appellee's evidence is carefully examined it will be noted that nowhere has Appellee's expert made any claim that the practices criticized would in fact destroy the frozen condition of the shipment. On the other hand, there is expert testimony which is positive to the effect that the method of handling used would not produce a change of temperature on the cartons which would be significant. [Tr. 517-519.] Maximum possible change would be 3° and that would involve only the cartons on the extreme outside of the truck as loaded.

Appellee cites the lack of specific written records as to product temperature and speculates that the merchandise might have been loaded into the car without sufficient freezer storage. (Reply Br. p. 10.] This conclusion is apparently predicated upon the fact that the witness Hailey who examined the car in Chicago could not recall observing chalk marks on the cartons. At the time Hailey saw the car it had been in transit for a week. He had no reason to know of the markings or to recognize their significance if he saw them. It is rank speculation to postulate that the shipment was not frozen on the basis of such evidence. Especially is this true because there was direct evidence from every person who participated in the actual loading process that only frozen cartons were placed in the car. [Tr. 40-41, 232, 241-242, 247, 248, 251.]

To support the challenged findings of the District Court Appellee places primary reliance upon the evidence adduced from the witness Hailey who made an inspection of some of the cartons in the car the day following its arrival at Chicago. (Reply Br. pp. 10-11.) Great stress is placed upon the testimony of this witness that he found cartons in the center of the load ranging from 44° to 64° and that the temperatures of cartons on the outside of the load were below freezing. [Tr. 340-341.] From this evidence Appellee postulates that the car must have been loaded warm and been cooled while in transit.

Some comment has already been made as to the credibility of the witness Hailey. His testimony is that he found cartons at 64° immediately surrounded on all sides by cartons, the temperature of which was below freezing. Admittedly, these cartons had been in contact with one another for nearly a week. What Mr. Hailey has said is that he took a paper carton containing sandwiches from the center of what amounts to a solid block of ice in which it had been embedded for nearly a week and found the contents unaffected by the chilling effect of the surrounding material. Although the experts both agreed this could not be, expert testimony to establish the fallacy of such a statement is certainly not needed. This Court is not required to accept the credibility of a witness as to testimony in direct conflict with the laws of nature.

In its discussion of the evidence of conditions found to exist at destination Appellee relies entirely upon the evidence of Mr. Hailey. The Appellee disregards entirely the testimony of the witness Pinski who was the man who actually opened the car upon arrival and made

the initial inspection. [Tr. 143-198.] Mr. Pinski was not an interested witness as was Mr. Hailey. Mr. Pinski's testimony as to where in the car the high temperatures were encountered contradicts that of Mr. Hailey in almost every respect. [Tr. 155, 159.] Cartons taken from the top two layers of the load reflected temperatures of 48° to 56°. [Tr. 159, Ex. 6.]

All of the evidence to which Appellee makes reference relates to conditions found to exist after the arrival of the shipment at destination. At that time the shipment had been in Appellee's possession for nearly a week. There is evidence, as above noted, that the car used had the capacity, if operating properly, to exert a considerable cooling effect upon the contents. The evidence is uncontradicted that on its return trip to Los Angeles the car was capable of reducing the temperature of a considerable number of the cartons from 64° to a completely frozen condition. [Tr. 49, 502.] The temperatures at this later date varied from 2° to a maximum of 18°. [Tr. 502.] The product involved is basically a cooked article when made. There was no necessity, in making a sandwhich, for its temperature to rise above the ambient temperature. Implicit in Appellee's argument is the proposition that the car, properly operating, could not reduce the temperature of cartons presumably placed in the car at room temperature below 64° on the six days of the trip east but that the same car could then take the temperature of the load down from 64° to a point below freezing in the same time on the return trip. The impossibility of Appellee's contention in face of natural laws is specifically shown in the record by the testimony of Appellant's expert whose studies showed that if as much as 40% of

the load had been at 60° when loaded all or substantially all of the load would have been frozen upon arrival had the car been operating properly. [Tr. 530.]

The Court's attention is directed once again to the fact that the District Court made no finding on the condition of the goods at the time of tender to the Appellee. All of the evidence to which Appellee has made reference and which is here under consideration is germane to that issue and that issue only. Implicit in the finding of the District Court (on Appellee's theory of the law) is a prior determination that the shipment was received in good order because it is only as to those cases in which the injury takes place while the shipment is in transit that it is necessary to make findings as to the due care of the carrier. Thus, in arguing the true basis of decision was that the shipment was not in good order when tendered, Appellee defeats its own contentions as to the status of the case at the time it was submitted for decision.

6. Conclusion.

The assumptions and speculations which are so important a part of the Appellee's arguments themselves serve to demonstrate that the District Court has erred in a number of important respects. Vital and important findings have been omitted. Findings which have been made are obviously predicated upon a misconception of the applicable law by the District Court. Its judgment is clearly erroneous and should be reversed.

Respectfully submitted,

THEODORE W. RUSSELL,
Attorney for Appellant.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

THEODORE W. RUSSELL

No. 18266

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

SHIRLEY MAY RIGDON,
Formerly Shirley May Kirschenmann,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLANT.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

STATUTES

MISCELLANEOUS PAGE

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BRIEF FOR THE APPELLANT.

Opinions Below.

The opinion and order of the District Court denying the Government's motion to dismiss (R. 66-77) are reported at 197 F. Supp. 150. The District Court's findings of fact, conclusions of law and judgment are reported at 209 F. Supp. 267. (R. 105-119.) Its memorandum and order (R. 96-104) are not officially reported.

Jurisdiction.

This appeal involves refunds of federal income taxes for the years 1944 through 1948. Claims for refund were filed on May 7, 1956, and were disallowed on December 16, 1958. (R. 114.) Within the time provided in Section 3772(a)(2) of the Internal Revenue

Code of 1939, and on December 16, 1960, taxpayer brought this action in the District Court for the recovery of taxes and interest thereon. (R. 3-52.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346(a). The Government's motion to dismiss was denied on August 30, 1961 (R. 66-77), and judgment was entered in favor of the taxpayer on May 2, 1962. (R. 119.) On June 29, 1962, the United States filed its notice of appeal. (R. 122.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

Question Presented.

Whether Sections 1311 to 1315 of the Internal Revenue Code of 1954 mitigate the effect of the expiration of the applicable statute of limitations so that the taxpayer may maintain her refund suit for each of the years 1944 through 1948.

Statutes Involved.

These are set out in the Appendix, *infra.*

Statement.

This case involves taxpayers's refund claims for the years 1944 through 1948. The claims are based upon a prior judicial proceeding which resulted in the disallowance of a rental deduction taken by the taxpayer's parents in 1944. *Kirschenmann v. Westover,* (S.D. Cal.), decided June 30, 1952 (44 A.F.T.R. 1271), affirmed, 225 F. 2d 69 (C. A. 9th), (No. 13,-736) certiorari denied, 350 U.S. 834.

The facts pertinent to the instant case are as follows:

The taxpayer, a resident of Kern County, California, is the daughter of Henry and Adeline Kirschenmann

and, since May 12, 1956, the wife of Donald Rigdon. (R. 106.)

In 1944 the taxpayer's parents deeded a quarter section of land to her. Her uncle, Edward Kirschenmann, was appointed her guardian in proceedings in the California Superior Court for Kern County, and, pursuant to an order of that court, the quarter section of land was leased back to taxpayer's parents for a five year term. (R. 106-108.)

Pursuant to the terms of that lease, taxpayer's father paid $19,412.54 for the year 1944. This amount was deducted by taxpayer's parents as purported rental for 1944 and reported as income on behalf of the taxpayer for that year. (R. 109, 110.) *Kirschenmann v. Westover, supra,* involved the rental deduction taken by the parents.

Taxpayer's father also deducted as alleged rental $22,351.65 for 1945, $21,346.94 for 1946, $7,200 for 1947, and $15,000 for 1948, and these amounts were reported as income on behalf of the taxpayer for those respective years. (R. 109-110.) While the amounts paid by taxpayer's father for the years 1945 through 1948 were not the subject of the court action in *Kirschenmann v. Westover, supra,* the District Court in the present case found that the purported rental payments for these years as well as 1944 were not required to be made as a condition to the continued use or possession of the subject real property for purposes of Henry Kirschenmann's trade or business. (R. 109, 115.)

In *Kirschenmann v. Westover, supra,* the District Court held that the taxpayer's parents retained an in-

terest in the property deeded to her and that the Commissioner properly refused to allow a deduction for the year 1944 for rent paid pursuant to the terms of their lease as an ordinary and necessary business expense. The judgment was affirmed by this Court on March 8, 1955, rehearing denied, May 31, 1955 (225 F. 2d 69); certiorari was denied on October 10, 1955 (350 U.S. 834); and this Court's mandate was issued on October 24, 1955. (R. 111-112.)

The time for asserting a deficiency against the parents for the year 1945 had expired (Exs. 17 and 17-A, R. 174-185); a deficiency was asserted for their years 1946 through 1948 based on the disallowance of the claimed rental deduction, and the deficiencies were paid. On March 12, 1958, parents filed refund claims for those years. No action has been taken on those claims by the Internal Revenue Service. (R. 112-113.)

Claims for refund of taxes paid by the taxpayer for the years 1944 through 1948 were filed on her behalf on May 7, 1956. (R. 114.) These claims, based on the allegedly erroneous inclusion in her income of the payments made by taxpayer's parents to her (R. 28-52), were disallowed on December 16, 1958. (R. 114.)

On December 16, 1960, taxpayer filed suit for refund of taxes paid for 1944 through 1948, based on the erroneous inclusion of these payments in her gross income for those years. (R. 3-52.) The court denied the Government's motion to dismiss, which motion was based on the untimely filing of the refund claims (R. 53-54, 66), and allowed the taxpayer to proceed to the merits of the case, finding that Sections 1311-1315 of

the 1954 Code applied to mitigate the bar of the statute of limitations (R. 66-77).

The District Court concluded that there had been a "determination" within the meaning of Section 1313 for each of the years 1944 through 1948; that the taxpayer and her parents were related taxpayers within the meaning of Section 1312(1); that the alleged rentals paid by taxpayer's parents for each of these years were erroneously included in her income; and that the Commissioner maintained an inconsistent position resulting in the double inclusion of an item of income for each of these years as provided by Section 1312(1). (R. 115-118.) Judgment was entered on May 2, 1962, awarding refunds plus interest to the taxpayer for each of the years in issue. (R. 119.)

The Government has appealed.

Specification of Errors Relied Upon.

1. The District Court erred by denying the Government's motion to dismiss.

2. The District Court erred in holding that the taxpayer satisfied the requirements of Sections 1311-1315 of the Internal Revenue Code of 1954, and, thus, that the taxpayer's refund claims for each of the years 1944 through 1948 were not barred by the three-year statute of limitations applicable to recovery of alleged overpayments of taxes.

3. The District Court erred in holding and deciding that judgment should be entered for the taxpayer and against the Government.

Summary of Argument.

Sections 1311-1315 of the 1954 Code provide that in certain specified circumstances the bar of the statute of limitations may be lifted in order for the Commissioner to assert a deficiency or a taxpayer to claim a refund. Thus, even though the ordinary period of limitations had long since expired when the refund claims for 1944 through 1948 were filed on behalf of the taxpayer in the instant case, if Sections 1311-1315 are applicable to the facts of her case, then her suit was properly considered by the District Court. It is the Government's position that the mitigation provision does not apply here.

Sections 1311-1315 represent an attempt by Congress to provide a relief measure for both the Commissioner and taxpayers, but they also represent a laborious attempt to protect the essential validity of the statute of limitations by limiting the relief to specifically defined situations.

The instant case does not fit into the framework of the mitigation provision. Thus, it is basic to the operation of the provision that only the "item" which is the subject of a prior "determination" may be the subject of an adjustment under Section 1314. The only determination relevant to this case, the prior judicial action in *Kirschenmann v. Westover, supra,* involved an item of rental which was deducted by taxpayer's parents in 1944. Nevertheless, the District Court held that the inclusion of this item in taxpayer's income for 1944 and other rental items for the years 1945 through 1948 justified the opening of taxpayer's years 1944 through 1948. This results in exclusion of alleged

rent paid to her by her parents in 1945 even though the parents took a rental deduction in 1945 and the Commissioner is barred by the statute of limitations from asserting a deficiency against them for that year. This result of her parents' tax avoidance scheme is wholly out of accord with the mitigation provision and illustrates that the conditions of the statute were meant to be complied with.

The fact is that the remaining errors of the District Court in finding the mitigation provision applicable result from a failure to consider the words of the provision as meaning what they say. Thus, the court held that the disallowance of the parents' rental deduction satisfies the circumstance of adjustment specified in Section 1312(1), *i.e.,* double inclusion of an item of gross income. The provision, however, has maintained from its beginnings in 1938 a strict distinction between items of income and items of deduction, and only in two special situations not present here are correlative inclusion-deduction situations between related taxpayers within its purview. The effect of holding that the disallowance of a deduction for the parents is an inclusion in their gross income is to make unnecessary the double disallowance of a deduction circumstance of adjustment (and to render ineffective the special rules which limit its applicability), making such a situation in effect a double inclusion circumstance of adjustment. The circumstance presented here is just not within the purview of the mitigation provision.

Furthermore, the inconsistent position requirement of the statute means that the prior determination with respect to taxpayer's parents must be logically inconsistent

with the inclusion of the alleged rental item in the taxpayer's gross income. But it is not inherent in the prior determination, and was not so asserted, that the payments to taxpayer in 1944 as alleged rental constituted a gift to her. The payments were considered part of a tax avoidance scheme which were made pursuant to a court-approved lease, and it would appear that the payments did not proceed from a "detached and disinterested generosity," which is the requisite for a gift. Thus, we submit that the inconsistent position requirement of the statute has not been satisfied.

Finally, the District Court held that the taxpayer and her parents were "related taxpayers" within the meaning of the statute, even though the relationships of parent-child, donor-donee, and lessor-lessee were intentionally omitted as separate categories. The court held that the relationship of guardian-ward, between taxpayer and her uncle, was subject to the law of trusts and that the grantor-beneficiary relationship in the statute is applicable here. However, the parents were not grantors in a trust situation, and this construction by the District Court in effect inserts into the statute as related taxpayers those relationships specifically excluded by Congress.

In short, the District Court has construed the mitigation provision in such a way as to make ineffective the very limitations which were painstakingly built into it. The judgment is erroneous and should be reversed.

ARGUMENT.

The District Court Erred in Holding That Under Sections 1311-1315 of the Internal Revenue Code of 1954 the Taxpayer's Refund Claims for the Years 1944 Through 1948 Were Timely.

Ordinarily, when the statute of limitations has run on the right of the Commissioner to assert a tax deficiency or on the right of a taxpayer to claim a refund for overpayment of tax, correction of errors in the barred year is not permitted. However, Sections 1311-1315 of the Internal Revenue Code of 1954 (Appendix, *infra*) provide that under specified circumstances where an error has been made in the inclusion or exclusion of a gross income item or in the allowance or disallowance of a deduction item or in the tax treatment of a transaction affecting the basis of property, the error may be corrected even though the ordinary period of limitations has run.[1]

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[1]This mitigation provision was first enacted as Section 820 of the Revenue Act of 1938, c. 289, 52 Stat. 447. The Senate Finance Committee stated the principles underlying the proposed legislation as follows (S. Rep. No. 1567, 75th Cong., 3d Sess., pp. 49-50 (1939-1 Cum. Bull. (Part 2) 779, 815)):

> The legislation here proposed is based upon the following principles:
>
> (1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency, and (b) under no circumstances affect the tax save with respect to the influence of the particular items involved in the adjustment.
>
> (2) Subject to the foregoing principles, disputes as to the year in which income or deductions belong, or as to the person who should have the tax burden of income or the tax benefit of deductions, should never result in a double tax or a double reduction in tax, or an inequitable avoidance of tax.
>
> (3) Disputes as to the basis of property should not allow the taxpayer or the Commissioner to obtain an unfair tax

Here, the time for filing refund claims specified in Section 322(b)(1) of the 1939 Code (Appendix, *infra*) had long since expired when claims for the years 1944 through 1948 were filed on behalf of the taxpayer in 1956 (R. 114), and there is no dispute that the taxpayer is not entitled to recovery in this suit if the mitigation provision is not applicable to each of the years in question.[2]

As pertinent to the instant case, Section 1311(a) provides that if a "determination," as defined in Section 1313, has been made with respect to an error as described in Section 1312, the effect of the error shall be corrected by an "adjustment" made in the amount and manner specified in Section 1314, if, on the date of the determination, correction of the error is otherwise prevented by a law such as the statute of limitations. Section 1311(b)(1) specifies as a necessary con-

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advantage by taking one position at the time of the acquisition or property and an inconsistent position at the time of its disposition.

(4) Corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer, and of establishing the proper basis.

[2]Of course, Sections 1311-1315 are not designed to afford mitigation of the effect of the statute of limitations in all cases, but only under particular defined and limited circumstances. See Maguire, Surrey & Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L. J. 509, 719 (1939); Holland, Tax Consequences of Inconsistent Position—A Review of Section 3801, N.Y.U. Institute on Federal Taxation (Tenth Annual, 1952) 807. And the party seeking the benefit of the statute is required to meet its specific requirements. *United States v. Rushlight,* 291 F. 2d 508 (C. A. 9th); *Hagan v. United States,* 239 F. 2d 141 (C. A. 9th); *Taxeraas v. United States,* 269 F. 2d 283 (C. A. 8th); *Sherover v. United States,* 137 F. Supp. 778, affirmed *per curiam,* 239 F. 2d 766 (C. A. 2d); *Heer-Andres Investment Co. v. Commissioner,* 22 T. C. 385; *Brennen v. Commissioner,* 20 T. C. 495; *MacDonald v. Commissioner,* 17 T. C. 934.

dition to the allowance of an adjustment under the circumstance of a double inclusion of an item of gross income that the determination must have "adopted" a position "maintained" by the Commissioner which is "inconsistent with the erroneous inclusion" in the gross income of a related taxpayer as defined in Section 1313(c).

The determination relevant to the instant case is based on prior court proceedings. In *Kirschenmann v. Westover* (S. D. Calif.), decided June 30, 1952 (44 A.F.T.R. 1271), affirmed, 225 F. 2d 69 (C.A. 9th) (No. 13,736), certiorari denied, 350 U.S. 834, a claimed deduction by Henry and Adeline Kirschenmann for alleged rental paid to their daughter in the year 1944 was disallowed. The position maintained by the Government and adopted by the District Court and this Court was that the rental agreement constituted a tax avoidance scheme and that the 1944 payments were not properly deductible under Section 23(a) of the 1939 Code.[3] This Court rendered its decision on March 8, 1955, and denied rehearing on May 31, 1955. The Supreme Court de-

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[3]Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. * * *

(26 U. S. C. 1952 ed., Sec. 23.)

nied certiorari on October 10, 1955. On May 7, 1956, claims for refund of taxes paid for the years 1944 through 1948 were filed on behalf of the daughter, taxpayer here. (R. 114.) The claims were disallowed on December 16, 1958 (R. 114), and this suit followed.

The District Court allowed the taxpayer to proceed to the merits of the case, holding that she had demonstrated the applicability of Sections 1311-1315 and that the bar of the statute of limitations is thereby lifted. (R. 66-77.) We submit, however, that this result disregards the laborious attempt of Congress to provide relief in well-defined circumstances, with appropriate safeguards against wholesale mitigation of the statute of limitations. And the remainder of his brief will show that the District Court erred in holding 1) that there was a circumstance of adjustment as defined in Section 1312; 2) that the determination here relevant (the prior judicial proceeding) involved the maintenance and adoption of an inconsistent position as required by Section 1311(b)(1); 3) that the taxpayer was a related taxpayer of her parents as defined in Section 1313(c); and 4) that the determination which involved a rental deduction for 1944 involved items of rent for 1945 through 1948 as to which there has been no other determination as defined in Section 1313(a).

A. The District Court Incorrectly Held That There Was a Circumstance of Adjustment as Provided in Section 1312.

It is fundamental to the scheme of federal income taxation that Congress has provided for the inclusion in gross income of all items of gain or income except those specifically excluded. See Internal Revenue Code of 1954, Section 61 (Appendix, *infra*); *Commissioner*

v. Glenshaw Glass Co., 348 U.S. 426, rehearing denied, 349 U.S. 925. Equally fundamental is the proposition that deductions are a matter of legislative grace, and only such deduction items as are provided in the statute are properly to be taken from gross income in computing taxable income. See Internal Revenue Code of 1954, Section 62 and Section 63 (Appendix, *infra*); *Deputy v. duPont,* 308 U.S. 488. The distinction between items of gross income and items of deduction has been clearly recognized by the Supreme Court. See *Spring City Co v. Commissioner,* 292 U.S. 182; *Commissioner v. Hansen,* 360 U.S. 446. And the distinction is inherent in the makeup of Section 1312 of the 1954 Code, which describes the various circumstances of adjustment within the purview of the mitigation provision.

It may be seen that with the exception of the circumstances of adjustment embraced by Section 1312(5) and Section 1312(6),[4] the specified circumstances of adjustment refer to either the double inclusion or exclusion of an income item or the double allowance or disallowance of an item of deduction or credit.

The District Court held that the facts of the instant case are within the purview of Section 1312(1), which specifies that the prior determination (here the judicial proceeding in which a rental deduction taken by the taxpayer's parents for 1944 was disallowed) "requires the inclusion in gross income of an item which was erroneously included in the gross income * * * of a related taxpayer." The fact is, however, that there

[4]Section 1312(7) relates to the special problem of basis after erroneous treatment of a prior transaction.

was no determination with respect to income items reported by taxpayer's parents, since the determination related to a deduction item which was disallowed as not satisfying the requirements of Section 23(a) of the 1939 Code (quoted in footnote 3, *supra*).

The distinction between items includible in gross income and items deductible from gross income is basic to the functioning of the mitigation provision as enacted by Congress. Thus, the provision as it originally appeared (Section 820 of the Revenue Act of 1938, c. 289, 52 Stat. 447) included circumstances of adjustment with respect to the double inclusion of an item of gross income, the double allowance of a deduction or credit, and the double exclusion of an item of gross income with respect to which tax was paid. Even though a fiduciary and a beneficiary were then, as now, related taxpayers, it was necessary to include a special circumstance of adjustment to provide for the correlative inclusions in gross income and deductions from gross income as provided by the statute dealing with the taxation of trusts. This special circumstance of adjustment, which now appears as Section 1312(5), was made necessary because the related taxpayer provisions of the other circumstance of adjustment did not remedy a situation where, for example, a trustee was disallowed a deduction but the beneficiary had nonetheless included amounts distributed to him in his gross income. See Maguire, Surrey & Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L. J. 509, 719 (1938), pp. 759-761.

Similarly, in 1958, Congress added a new circumstances of adjustment, Section 1312(6), which pro-

vides for correlative deductions and credits for certain related corporations. This provision was intended to remedy the situation, not otherwise covered, in which, for example, claimed interest deductions of one corporation had been disallowed as representing dividends and the corresponding intercorporate dividend credit had not been taken by the other corporation. See S. Rep. No. 1983, 85th Cong., 2d Sess., p. 81 (1958-3 Cum. Bull. 922, 1002-1003).

It is clear that the statute as originally enacted made a sharp distinction between income items and deduction items. If such a distinction were not followed, then the whole point of dealing separately with deduction items would be lost, obviously contrary to the congressional intent. Thus, for example, Section 1312(4) pertains to a double disallowance of a deduction case, but even though the applicability of this provision is subject to special rules to limit its effect (see Section 1311-(b)(2)(B)), the result of the District Court's decision here would be to turn such a situation into a double inclusion of an item of gross income cognizable under Section 1312(1).

The District Court cited *Gooch Milling & Elevator Co. v. United States,* 78 F. Supp. 94 (C. Cls.), as support for its holding in this case that the disallowance of the rental deduction in the prior suit was an inclusion in gross income. (R. 74-76, 103-104.) We submit that the *Gooch* case and other cases relating to inventory adjustments[5] are not authority for treating

[5]See *H. T. Hackney Co. v. United States,* 78 F. Supp. 101 (C. Cls.); *Moultrie Cotton Mills v. United States,* 151 F. Supp. 482 (C. Cls.); *United States v. Rachal* (C. A. 5th), decided

items not properly deductible from gross income as inclusions in gross income. It must be remembered that for an accrual basis taxpayer using inventories gross income from business means gross receipts less cost of goods sold. Cost of goods sold is computed by adding inventory held at the beginning of the year and purchases made during the year, and subtracting from this figure inventory still on hand at the end of the year. The greater the cost of goods sold, the lower the gross income from business, and vice versa; and if the value of inventory items is changed, the gross income figure is likewise changed. It was on the basis of this analysis that the Court of Claims made its decision in the *Gooch* case. See 78 F. Supp. pp. 98-99. We fail to see, however, how this rationale supports the holding of the District Court in the instant case. The Internal Revenue Code specifically provides that items of deduction such as rent are deductions *from* gross income (see Section 62 and Section 63 of the Internal Revenue Code of 1954), while Sections 1311-1315 specifically maintain the distinction between deduction items and items of gross income.

The fact is that the instant case does not involve a circumstance of adjustment as specified in Section 1312, and the taxpayer's suit should have been dismissed by the District Court.

December 27, 1962 (63-1 U. S. T. C., par. 9150). See also, *M. Fine & Sons Manufacturing Co. v. United States,* 168 F. Supp. 769 (C. Cls.), and this Court's consideration of that case in *United States v. Rushlight,* 291 F. 2d 508.

B. The District Court Incorrectly Held That There Was Adopted in the Determination (the Prior Suit in Which Taxpayer's Parents Were Disallowed a Rental Deduction) a Position Maintained by the Commissioner Which Is Inconsistent With the Inclusion in Taxpayer's Gross Income.

Section 1311(b)(1) specifies that the mitigation provision applies under the circumstance of a double inclusion only if the prior determination *adopted* a position *maintained* by the Commissioner which is inconsistent with the erroneous inclusion in the related taxpayer's gross income. The inconsistent position requirement, perhaps the most difficult concept appearing in this group of sections, requires a word of explanation to place it in proper focus.

As originally enacted, the mitigation provision contained the inconsistent position requirement with respect to all circumstances of adjustment then provided for. A circumstance of adjustment not provided for, however, now appears as Section 1312(4), and is applicable to the double disallowance of a deduction or credit situation. In discussing the failure of the statute as originally enacted to include such a provision, Maguire, Surrey & Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L. J. 509, 719, 758, commented as follows:

> Section 820, however, in neither initial nor final form, covered the situation where the determination disallows a deduction which was erroneously disallowed or omitted in another taxable year. The omission of this case from Section 820 has given rise to severe criticism of the section, and yet from the discussion above it is clear that its in-

clusion would have had the effect of destroying the statute of limitations with respect to deductions. The taxpayer who neglected to take a deduction properly allowable for 1935, as to which year the period of limitations on refund claims had expired, could take that deduction in his return for 1940, or 1941, etc., or claim a refund for those years, force the Commissioner to take a position inconsistent with the omission of the deduction in 1935,[153] and then, after the Commissioner had won the case, claim an adjustment for 1935. Congress recognized that Section 820 was not the proper vehicle for solving the bad debt problem, for the cure would have been worse than the disease, and consequently the "failure to obtain a deduction" case is not found in subsection (b).[154]

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[153]The text assumes that the Commissioner to win the case would be forced to specify the year in which the deduction was properly allowable, here 1935, so that he would thereby be maintaining an inconsistent position. If, as is the situation in most bad debt and stock worthlessness cases, the Commissioner successfully defended solely on the ground that the debt did not become bad, or the stock worthless, in the year claimed by the taxpayer, and did not specify the year in which the deduction was properly allowable, there would not be a maintenance of an inconsistent position by the Commissioner and an adjustment could not be obtained by the taxpayer even if the "failure to obtain a deduction" situation were covered in subsection (b).

[154]While a shift of position was evident in the omission of income cases where tax was later paid, so that subsection (b)(3) could be included, Congress apparently thought that there was no comparable standard in the deduction cases. It may be possible to provide that, if the deduction had been denied by the Commissioner for the earlier year, later disallowance, where the Commissioner had maintained that the deduction was allowable for the year for which it had previously been claimed and denied, would result in an adjust-

As this text and footnote commentary indicate, the inconsistent position provision requires that the position maintained by the Commissioner and adopted in the determination be logically inconsistent with the treatment of the item in a closed year or by a related taxpayer. In the words of one commentator (Mullock, The Inconsistent Position: Section 1311(b)(1), 12 Mercer L. Rev. 300, 302):

> The Statute rests on the proposition that the determination when final represents truth. It follows from this that if the respective treatments accorded the same item in the determination and in a closed year cannot both be true then they are contradictions and hence logically inconsistent.

In 1953, the circumstances of adjustment now appearing as Sections 1312(3)(B) and 1312(4) of the 1954 Code were enacted (as Section 3801(b)(6) and (7) of the 1939 Code (26 U.S.C. 1952 ed., Sec. 3801)). In the double disallowance of a deduction case the Commissioner may argue that the original disallowance was based on the failure of the taxpayer involved to meet the statutory criteria and not on the fact that the deduction should properly be taken in an-

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ment, as here the earlier denial indicates the shift of position on the part of the Commissioner and thus provides a standard whereby the case in which the Commissioner took no action with respect to the earlier year may be differentiated. If, however, the later disallowance did not involve the maintenance of an inconsistent position, but simply resulted from the successful assertion by the Commissioner that the deduction was not allowable in the later year, no adjustment could be secured. See note 153, *supra*. It has been suggested (Comment (1938) 52 Harv. L. Rev. 300, 304, that adjustment be allowed to the taxpayer who claimed a deduction in the wrong year when he could prove that he had acted in good faith. The academic merit of such a plan is outweighed, however, by practical administrative difficulties.

other specific year or by a related taxpayer. In the double exclusion of income situation the taxpayer may argue that an income item is not properly includible in his gross income, not maintaining that it is includible in a specific prior year or in the income of a related taxpayer. Thus, the provisions now appearing as Section 1311(b)(2)(A) and (B) were enacted to omit the inconsistent position requirement from these two circumstances of adjustment, with other safeguards being provided, the House Ways and Means Committee noting as follows (H. Rep. No. 894, 83d Cong., 1st Sess., p. 24 (1953-2 Cum. Bull. 508, 525)):

> The amendment to the second sentence of Section 3801(b) excepts cases described in paragraphs (6) (7) from the requirement that the adjustment be made only in cases where the other party has maintained an inconsistent position, since cases described in paragraphs (6) and (7) are not attributable to the maintenance of an inconsistent position by the other party to the dispute.

See also, S. Rep. No. 685, 83d Cong., 1st Sess., p. 10 (1953-2 Cum. Bull. 526, 532).

In the instant case the District Court found the existence of an inconsistent position, presumably, by considering the payments made to the taxpayer as gifts. It should be noted, however, that the Commissioner was under no obligation to specify what he considered the disallowed rental deduction to represent in the hands of the recipient of the payments, and the same is true of the courts that considered the prior action. See *Utter-McKinley Mortuaries v. Commissioner*, 225 F. 2d 870, 873 (C.A. 9th). The position maintained by the Com-

missioner and adopted in the determination was that the taxpayer's parents failed to qualify for the deduction taken by them as alleged "rentals or other payments required to be made as a condition to the continued use or possession, for the purposes of the trade or business of property * * *." The Commissioner and the courts considered the payments as in effect the purchase of a tax deduction, not a gift. See 225 F. 2d 69-71. And the necessary result of this determination is not inconsistent with the inclusion of the payments for 1944, however they might be characterized, in the recipient's gross income. See *Commissioner v. Duberstein,* 363 U.S. 278, 285-286, in which the Supreme Court made it clear that the transferor's intention to make a gift (which proceeds from "a detached and disinterested generosity" not "from the incentive of anticipated benefit of an economic nature") is the ultimate fact to be determined when the question of whether a specific payment represents a gift is presented.

The prior determination upon which this case is based indicates that the payments did not proceed from a "detached and disinterested generosity" but rather from a conscious effort to purchase a tax deduction through the use of a state court-approved lease agreement. In any event, no position was maintained by the Commissioner or adopted in the determination that was inconsistent with the inclusion of the payments in taxpayer's gross income. Whether the alleged rental payments in fact represented gifts to the taxpayer would be a proper subject of consideration only if Sections 1311-1315 were applicable to lift the bar of the statute of limitations. We submit that the basic requirement of an in-

consistent position is lacking and that for this reason, as well as for the reason that no circumstance of adjustment is present, the mitigation provision cannot be applied in favor of the taxpayer.

C. The Taxpayer Is Not a Related Taxpayer of Her Parents Within the Meaning of Section 1313(c).

Under Section 1313(c), seven relationships are specified in the definition of "related taxpayers." The District Court held that because under California law the relationship of guardian and ward is subject to the law of trusts, the requisite related taxpayer situation exists in this case between taxpayer and her parents, *i.e.,* the grantor-beneficiary relationship of Section 1313(c)(3). (R. 72-74, 102-103.)

The taxpayer's uncle was appointed her guardian (Exs. 1 and 2, R. 158-161), and he thereafter entered into a lease on her behalf with taxpayer's parents (Exs. 10 and 11, R. 168-173). Indeed her uncle stood in a fiduciary relationship with respect to the taxpayer and was subject to court control, but he was only acting on her behalf; for, the underlying property which was the subject of the lease was deeded to the taxpayer by her parents. (Exs. 9 and 9-A, R. 166-168.) The parents were not the grantors in a trust situation, and the relationship between them and the taxpayer was not that of grantor and beneficiary. Rather, the parties stood in the relationships of parents-child, donors-donee, and, purportedly, lessors-lessee.

When the mitigation provision was first enacted as Section 820 of the Revenue Act of 1938 the Conference Committee noted as follows (H. Conference Rep. No.

2330, 75th Cong., 3d Sess. (1938), p. 58 (1939-1 Cum. Bull. (Part 2) 817, 836):

> The conference agreement adopts the substance of the Senate amendment, but makes several changes. the important changes are as follows:
>
> * * *
>
> (3) Assignor and assignee, donor and donee, lessor and lessee, and claimants to ownership of the same property, are eliminated as independent categories of related taxpayers.

It can be seen that the relationships specified in the statute were meant to be exclusive, that parent-child, donor-donee, and lessor-lessee were not omitted from the statute through inadvertence. The fact is that tax avoidance schemes involving parents and their children in the relationships existing in the instant case were intentionally omitted from the benefits afforded by the mitigation provision. The District Court has unjustifiably reinstated the excluded relationships by finding that the taxpayer and her parents were related taxpayers within the meaning of the statute. We submit that the mitigation provision is not applicable to the facts here for this reason in addition to those previously discussed.

D. The District Court Incorrectly Held That There Has Been a Determination With Respect to Any Items for the Years 1945 Through 1948.

The mitigation provision is properly invoked only if there has been a "determination" as defined in Section 1313(a), and, in the case of a refund, only if the refund claim is filed within one year from the date of the determination, as specified in Section 1314(b). The determination relevant to this case is the prior

judicial action in *Kirschenmann v. Westover* (S.D. Calif.), decided June 30, 1952 (44 A.F.T.R. 1271), affirmed, 225 F. 2d 69 (C.A. 9th), certiorari denied, 350 U.S. 834. See Section 1313(a)(1). Within one year from the date the judgment in that case had become final, claims for refund were filed on behalf of the taxpayer.[6]

The prior judicial action involved an item of rent which was taken as a deduction by taxpayer's parents for 1944. No other year and no other rental deduction was involved in that case. Nevertheless, the District Court has held that taxpayer's refund claims for the years 1944 *and* 1945 through 1948 were timely,[7] based upon the prior court action. (R. 70-71, 100-101.)

The effect of this holding is to exclude the payments made to the taxpayer in 1945 from her income even though the statute of limitations had run against the Commissioner before he could seek a disallowance of the rental deductions taken by her parents in 1945. (See Ex. 17, at R. 176-179 and Ex. 17-A, at R. 182.)

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[6]The claims for refund were filed on May 7, 1956 (R. 114), clearly within the one year period specified in the statute.

The difficulty in determining at what point a court decision has become final is illustrated by the case of *Gill v. Commissioner,* 306 F. 2d 902 (C.A. 5th).

[7]The Commissioner asserted deficiencies against the parents for the years 1946, 1947, and 1948, based upon the disallowance of similar rental deductions taken by them for those years. (R. 112-113.) The parents have filed refund claims for those years, but no action has been taken by the Commissioner, and the claims have not been finally disposed of; thus there has been no "determination" within the meaning of the statute with respect to these claims. See Section 1313(a)(3). The parents have not entered into any agreement with the Commissioner with respect to their liability for the years 1946, 1947, and 1948, which might invoke the mitigation provision on behalf of the taxpayer here. See Section 1313(a)(4).

The tax avoidance scheme of taxpayer's parents with respect to 1945 would thus be successful beyond their hopes if the District Court's holding is allowed to stand.

The error of the District Court in finding Sections 1311-1315 applicable to the years 1945 through 1948 lies in the failure to distinguish between the theory of the disallowance for 1944 and the "item" involved. The mitigation provision is based on the concept of items. It is the item which is the subject of the determination referred to in Section 1312, and it is only with respect to this item that an adjustment with respect to a related taxpayer is authorized under Section 1314. *Gill v. Commissioner,* 306 F. 2d 902 (C.A. 5th); *Cory v. Commissioner,* 261 F. 2d 702 (C.A. 2d), certiorari denied, 359 U.S. 966; *First Nat. Bank of Phila. v. Commissioner,* 205 F. 2d 82 (C.A. 3d); *Central Hanover Bank & Trust Co. v. United States,* 163 F. 2d 60 (C.A. 2d); *Estate of A. W. SoRelle v. Commissioner,* 31 T.C. 272; *MacDonald v. Commissioner,* 17 T.C. 934.

What is meant by "item" as used in Sections 1311-1315 is summarized by Maguire, Surrey & Traynor in their often-quoted article, cited *supra,* as follows (pp. 751-752):

> The tax liability for a year is generally a unitary matter, and the concern is whether the correct dollars and cents total has been determined. Section 820, however, fastens upon the treatment accorded a particular item in different years regardless of the correct dollars and cents tax liability for those years. Some difficulty, therefore, may arise in ascertaining what is an "item." The term is not a new one in the income tax— Section 42 refers

> to the "amount of all items of gross income," Section 22(b) provides that the "following items shall not be included in gross income." The term "item" thus refers in a qualitative sense to the various matters which make up gross income — salary, dividends, rent, gain on sale of a capital asset, distributed trust income, interest, etc. Salary for 1937 and salary for 1938 are two different items, though in each case the amount may be $10,000. But if the item is qualitatively the same, as salary for 1937 included in gross income for 1937 and again for 1940, it is immaterial that there is a quantitative difference.

It is obvious that only rental taken as a deduction by taxpayer's parents in 1944 was the subject of the prior judicial proceeding, the determination applicable here. While rental deductions for 1945 through 1948 were perhaps improperly taken by the taxpayer's parents, they were not a subject of the prior determination. It is this type of separate and distinct, although possibly similar, item which is not affected by the adjustments under Sections 1311-1315. *Gill v. Commissioner, supra; First Nat. Bank of Phila. v. Commissioner, supra; Central Hanover Bank & Trust Co. v. United States, supra; Estate of A. W. SoRelle v. Commissioner, supra; MacDonald v. Commissioner, supra.*

The District Court relied on the case of *H. T. Hackney Co. v. United States,* 78 F. Supp. 101 (C. Cls.), for its holding that the taxpayer's years 1945 through 1948 may be adjusted. (R. 71, 100-101.) The *Hackney* case involved inventory adjustments for 1938 and 1939, which corrected an accumulated inflation of inventory values from the year 1933. The Court of

Claims allowed a refund for the years 1933 through 1936, because the determination for 1938 included overvaluations (and thus overpayments) in the prior years which, in fact, resulted in the 1938 adjustment. The court was very careful to relate the subject of the 1938 determination to the subject of the prior erroneous treatment in 1933-1936.

Whether the Court of Claims was correct in the *Hackney* case is not the point. It is not authority for the result reached by the District Court in the instant case, a result clearly in conflict with the above-cited authorities.

Conclusion.

For the foregoing reasons, the judgment of the court below should be reversed.

Respectfully submitted,

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Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Date: 26th day of February, 1963

HERBERT D. STURMAN,
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APPENDIX.

Internal Revenue Code of 1939:

SEC. 322. REFUNDS AND CREDITS.

* * *

(b) *Limitation On Allowance.*—

(1) *Period of limitation.*—Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

* * *

(26 U.S.C. 1952 ed., Sec. 322.)

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

* * *

(26 U.S.C. 1958 ed., Sec. 61.)

SEC. 62. ADJUSTED GROSS INCOME DEFINED.

For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:

(1) *Trade and business deductions.*—The deductions allowed by this chapter (other than by part VII of this subchapter) which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee.

* * *

(26 U.S.C. 1958 ed., Sec. 62.)

SEC. 63. TAXABLE INCOME DEFINED.

(a) *General Rule.*—Except as provided in subsection (b), for purposes of this subtitle the term "taxable income" means gross income, minus the deduc-

tions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

(b) *Individuals Electing Standard Deduction.*—In the case of an individual electing under section 144 to use the standard deduction provided in part IV (sec. 141 and following), for purposes of this subtitle the term "taxable income" means adjusted gross income, minus—

(1) such standard deduction, and

(2) the deductions for personal exemptions provided in section 151.

(26 U.S.C. 1958 ed., Sec. 63.)

SEC. 1311. CORRECTION OF ERROR.

(a) *General Rule.*—If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

(b) *Conditions Necessary For Adjustment.*—

(1) *Maintenance of an inconsistent position.*—Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be made under this part only if—

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there

is adopted in the determination a position maintained by the Secretary or his delegate, or

(B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made,

and the position maintained by the Secretary or his delegate in the case described in subparagraph (A) or maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.

(2) *Correction not barred at time of erroneous action.*—

(A) *Determination described in section 1312(3)(B).*—In the case of a determination described in section 1312(3)(B) (relating to certain exclusions from income), adjustment shall be made under this part only if assessment of a deficiency for the taxable year in which the item is includible or against the related taxpayer was not barred, by any law or rule of law, at the time the Secretary or his delegate first maintained, in a notice of deficiency sent pursuant to section 6212 or before the Tax Court of the United States, that the item described in section 1312(3)(B) should be included in the gross income of the taxpayer for the taxable year to which the determination relates.

(B) *Determination described in section 1312 (4).*—In the case of a determination described in section 1312(4) (relating to disallowance of certain deductions and credits), adjustment shall be made under this part only if credit or refund of the overpayment attributable to the deduction or credit described in such section which should have been allowed to the taxpayer or related taxpayer was not barred, by any law or rule of law, at the time the taxpayer first maintained before the Secretary or his delegate or before the Tax Court of the United States, in writing, that he was entitled to such deduction or credit for the taxable year to which the determination relates.

(3) *Existence of relationship.*—In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency (except for cases described in section 1312(3)(B), the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Tax Court of the United States for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

(26 U.S.C. 1958 ed., Sec. 1311.)

SEC. 1312. CIRCUMSTANCES OF ADJUSTMENT.

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

(1) *Double inclusion of an item of gross income.*—The determination requires the inclusion in

gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

(2) *Double allowance of a deduction or credit.*—The determination allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer.

(3) *Double exclusion of an item of gross income.*—

(A) *Items included in income.*—The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year, or from the gross income of a related taxpayer; or

(B) *Items not included in income.*—The determination requires the exclusion from gross income of an item not included in a return filed by the taxpayer and with respect to which the tax was not paid but which is includible in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

(4) *Double disallowance of a deduction or credit.*—The determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year, or to a related taxpayer.

(5) *Correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs.*—The determination allows or disallows any

of the additional deductions allowable in computing the taxable income of estates or trusts, or requires or denies any of the inclusions in the computation of taxable income of beneficiaries, heirs, or legatees, specified in subparts A to E, inclusive (secs. 641 and following, relating to estates, trusts, and beneficiaries) of part I of subchapter J of this chapter, or corresponding provisions of prior internal revenue laws, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer.

(6) [As amended by Sec. 59(a) of the Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606] *Correlative deductions and credits for certain related corporations.*—The determination allows or disallows a deduction (including a credit) in computing the taxable income (or, as the case may be, net income, normal tax net income, or surtax net income) of a corporation, and a correlative deduction or credit has been erroneously allowed, omitted, or disallowed, as the case may be, in respect of a related taxpayer described in section 1313(c)(7).

(7) [As renumbered by Sec. 59(a) of the Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606] *Basis of property after erroneous treatment of a prior transaction.*—

* * *

(26 U.S.C. 1958 ed., Sec. 1312.)

SEC. 1313. DEFINITIONS.

(a) *Determination.*—For purposes of this part, the term "determination" means—

(1) a decision by the Tax Court or a judgment decree, or other order by any court of competent jurisdiction, which has become final;

(2) a closing agreement made under section 7121;

(3) a final disposition by the Secretary or his delegate of a claim for refund. For purposes of this part, a claim for refund shall be deemed finally disposed of by the Secretary or his delegate—

(A) as to items with respect to which the claim was allowed, on the date of allowance of refund or credit or on the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(B) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Secretary or his delegate in reduction of the refund or credit, on expiration of the time for instituting suit with respect thereto (unless suit is instituted before the expiration of such time); or

(4) under regulations prescribed by the Secretary or his delegate, an agreement for purposes of this part, signed by the Secretary or his delegate and by any person, relating to the liability of such person (or the person for whom he acts) in respect of a tax under this subtitle for any taxable period.

* * *

(c) *Related Taxpayer.*—For purposes of this part, the term "related taxpayer" means a taxpayer who with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:

(1) husband and wife,
(2) grantor and fiduciary,
(3) grantor and beneficiary,
(4) fiduciary and beneficiary, legatee, or heir,
(5) decedent and decedent's estate,
(6) partner, or
(7) member of an affiliated group of corporations (as defined in section 1504).

(26 U.S.C. 1958 ed., Sec. 1313.)

SEC. 1314. AMOUNT AND METHOD OF ADJUSTMENT.

(a) *Ascertainment of Amount of Adjustment.*—In computing the amount of an adjustment under this part there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be the excess of—

(1) the sum of—

(A) the amount shown as the tax by the taxpayer on his return (determined as provided in section 6211(b)(1) and (3), relating to the definition of deficiency), if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in section 6211(b)(2), made. There shall then be ascertained the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error (with due regard given to the effect of the item in the computation of gross income, taxable income, and other matters under this subtitle). A similar computation shall be made for any other taxable year affected, or treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryover as defined in section 1212), determined with reference to the taxable year with respect to which the error was made. The amount so ascertained (together with any amounts wrongfully collected as additions to the tax or interest, as a result of such error) for each taxable year shall be the amount of the adjustment for that taxable year.

(b) *Method of Adjustment.*—The adjustment authorized in section 131(a) shall be made by assessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary or his delegate with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with respect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assessment or filing claim for

refund for such taxable year or years. If, as a result of a determination described in section 1313(a)(4), and adjustment has been made by the assessment and collection of a deficiency or the refund or credit of an overpayment, and subsequently such determination is altered or revoked, the amount of the adjustment ascertained under subsection (a) of this section shall be redetermined on the basis of such alteration or revocation and any overpayment or deficiency resulting from such redetermination shall be refunded or credited, or assessed and collected, as the case may be, as an adjustment under this part. In the case of an adjustment resulting from an increase or decrease in a net operating loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss arises.

(c) [As amended by Sec. 59(b) of the Technical Amendments Act of 1958. P. L. 85-866, 72 Stat. 1606] *Adjustment Unaffected By Other Items.*—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this part, shall not be diminished by any credit or set-off based upon any item other than the one which was the subject of the adjustment. The amount of the adjustment under this part, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item other than the one which was the subject of the adjustment.

* * *

(26 U.S.C. 1958 ed., Sec. 1314.)

SEC. 1315. EFFECTIVE DATE.

(a) *In General.*—This part shall apply only to determinations (as defined in section 1313(a)) made after the 90th day after the date of enactment of this title.

(26 U.S.C. 1958 ed., Sec. 1315.)

UNITED STATES COURT OF APPEALS

NINTH CIRCUIT

RAY W. CHRISTENSEN, TRUSTEE,

Appellant

-vs-

CASE NO. 18267

ROBERT T. FELTON and JEAN WILSON FELTON,

Appellees

REPLY TO PETITION FOR REHEARING

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UNITED STATES COURT OF APPEALS

NINTH CIRCUIT

RAY W. CHRISTENSEN, TRUSTEE,

Appellant

-vs- CASE NO. 18267

ROBERT T. FELTON and JEAN WILSON FELTON,

Appellees

REPLY TO PETITION FOR REHEARING

TO THE HONORABLE THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

Robert T. and Jean W. Felton, respondents in the above entitled case and in this petition, do hereby submit a response to the petition for rehearing, pursuant to an order issued under Rule 23 by this Court on August 27, 1963.

1. Appellees have no knowledge of the existence of evidence contradicting testimony introduced before the referee and considered by the District Court; however, appellees are in no position to assert that such evidence does not exist after the assertion which appears in appellants' petition for rehearing.

2. The record is replete with evidence of the defalcations of petitioner's officers; this was presented

in the course of oral argument and considered by the Court in its opinion. In addition to this, counsel would point to the following portion of the transcript which falls outside the offer of proof and bears upon the issue of fraudulent diversion of assets.

> "McDonnell took possession of the physical assets of Washburn-Wilson and operated the same and the business in connection therewith in conjunction with McDonnell and combined the business operation of both corporations which created indebtedness to various creditors on account of uncollectable accounts receivable, which decreased the working capital of McDonnell and made operations of the combined businesses impossible without additional funds or extensions of credit." Exhibit #10 TR 218 (admitted in evidence)

3. We would call the attention of the Court to a case, F. H. McGraw Co. v. Wilcox Steel Co., 149 F2 301 (2nd Cir. 1945) cited in Appellees' brief in which the Court, in passing on consideration of evidence by it which was refused by the District Court, says at page 306: "And the objection is of no importance in any event at this stage of the case, because the evidence appears of record and we are entitled to consider it, if legitimate, even had the District Court actually excluded it for the purpose offered." This principle would appear to be even more appropriate as applied to consideration by the District Judge of evidence sub mitted by way of offer of proof before the referee. H

control over the referee is extensive, extending to modification of the referee's order or the receipt of further evidence leading to additional or contrary findings without resubmission to the referee. 11 U. S. C. 11, Section 2 (a) (10); General Order #47; II Colliers: 3928, page 1496 (14th Ed.).

4. In this case, proceedings before the referee occurred in which evidence relating to piracy of assets was excluded by him as irrelevant under the terms of the contract. On review by the District Judge, this ruling was overturned and the Trial Judge, in his opinion, states: "Here the purchaser and its officers from the record are shown to have breached their fiduciary duties to sellers and to have rendered the security worthless by their fraudulent conduct." (TR 85) The appellant did apply for rehearing, presumably under Rule 59, in the District Court and in this petition made no reference to the factual statement above set forth and no reference to the existence of further evidence bearing on the issue of piracy. Now, for the first time on appeal before this Court their suggestion of existence of this evidence is advanced. This would appear to be a case of invited error and barred by the familiar rule which requires issues to be presented for the first time in the Trial Court. Petitioner had ample opportunity to request the right

to introduce additional evidence before the Trial Court or, at that time, request remand to the referee. Appellant's argument has been addressed to the construction of this contract and only as an afterthought is this argument of inability to introduce contrary evidence raised. If there was any failure, it was on the part of appellant and falls within the rule of invited error; petitioner should not be extended the privilege of twice trying his case. He had his opportunity to present this additional evidence and waived it. After the extensive proceedings which have already occurred, he should not be permitted to return and relitigate this entire case. There must be an end to proceedings sometime, a rule of finality to meet straw-grasping.

We respectfully pray that the petition for rehearing be dismissed and the original order to affirm permitted to stand.

Respectfully submitted,

Philip E. Peterson

I, PHILIP E. PETERSON, Counsel of record for Petitioner, hereby certify that in my judgment the foregoing Reply to Petition for Rehearing is well founded and that it is not interposed for delay.

DATED this 18th day of Sept., 1963.

Philip E. Peterson

UNITED STATES COURT OF APPEALS

NINTH CIRCUIT

RAY W. CHRISTENSEN, TRUSTEE,

Appellant CASE NO. 18267

-vs-

ROBERT T. FELTON and JEAN WILSON FELTON,

Appellees

PETITION FOR REHEARING

BROWN & THAYER
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Attorneys for Appellant

UNITED STATES COURT OF APPEALS

NINTH CIRCUIT

RAY W. CHRISTENSEN, TRUSTEE,

Appellant CASE NO. 18267

-vs-

ROBERT T. FELTON and JEAN WILSON FELTON,

Appellees

PETITION FOR REHEARING

TO THE HONORABLE THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Ray W. Christensen, Trustee, appellant in the above cause and petitioner herein, does hereby respectfully request rehearing in the above entitled court and reversal of the opinion and decision of this court in this cause issued and filed herein July 16, 1963, which decision and opinion herein affirmed the opinion and decision of the United States District Court for the Eastern District of Washington, Northern Division.

This petition for rehearing is based upon the following grounds:

I.

The opinion as filed herein July 16 gives no consideration to the following facts:

(A) The subject contract was prepared and drawn by the sellers and their attorneys.

(B) There is no ambiguity in the language of the paragraph entitled "Term."

(C) There was no fraud or mistake alleged or involved in the execution of the contract.

(D) No error was assigned against the Referee's exclusion of the offered testimony, which same was permitted in the record solely and clearly by way of offer of proof.

II.

The opinion herein is based upon that part of the record which is only offer of proof and which should not be considered as testimony or evidence. The attorney for the trustee deliberately refrained from cross examination and refrained from offering contrary testimony and evidence, although such was and is available. The ruling contained in the Court's opinion now implies that parties in litigation will not be secure in reliance upon rulings of the presiding judge concerning evidence. It means that trial counsel will be compelled to cross examine matters submitted by offer of proof and will be impelled to meet the matters asserted in offers of proof with countering or rebuttal testimony or evidence.

III.

The other creditors of McDonnell Seed Company are not parties to the subject agreement. Equity requires that their rights be protected against the claims of the selling stockholders especially where the contract is clear and is their own deliberate act and agreement.

The claims of these selling stockholders should at least be subordinated to the claims of the other McDonnell Seed Company creditors.

Petitioner, for the foregoing reasons, respectfully requests this court to grant rehearing in this appeal and that upon such rehearing the court's opinion and decision of July 16, 1963 be reversed or amended to direct one of the following:

(1) Reversal of the District Court's decision.

(2) Subordination of the claims of appellees to the rights of other creditors of McDonnell Seed Company,

(3) Remand the matter to the Referee for the taking of further testimony.

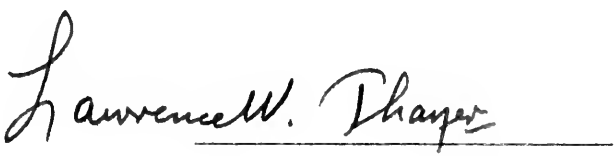
Respectfully submitted,

Brown & Thayer

Attorneys for Petitioner

I, LAWRENCE W. THAYER, of the law firm of Brown & Thayer, Counsel of record for Petitioner, hereby certify that in my judgment the foregoing Petition for Rehearing is well founded and that it is not interposed for delay.

DATED this 14th day of August, 1963.



No. 18269

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

BEATRICE RAUCH, a Widow,

Petitioner,

vs.

UNDERWRITERS AT LLOYD'S OF LONDON,

Respondent.

PETITION FOR REHEARING

WALTER R. RODGERS, III
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RICHTER, RODGERS,
WIMBERLEY & ERICSON,
of Counsel.

INDEX

TABLE OF CASES

No. 18269

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

BEATRICE RAUCH, a Widow,

Petitioner,

vs.

UNDERWRITERS AT LLOYD'S OF LONDON,

Respondent.

PETITION FOR REHEARING

TO THE HONORABLE THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT:

The petitioner herein respectfully prays for a rehearing by the Court en banc and a reversal of the decision of this Court of July 8, 1963, Cause No. 18269, which affirmed the order of the District Court dismissing petitioner's action with prejudice. Petitioner prays for rehearing en banc for the following reasons:

FIRST

The District Court, in its Pre-Trial Order, ruled "that the laws of the State of Washington shall apply to the construction of the insurance contract."

The majority opinion makes no mention of any Washington cases, and does not interpret appellee's contract by the rules of construction enunciated by the Supreme Court of the State of Washington.

Subsequent to oral argument before this Court, but before its opinion, by letter dated May 7, 1963, counsel for appellant invited this Court's attention to the most recent opinion of the Supreme Court of the State of Washington, Thompson v. Ezzell, Vol. 161, No. 15, page 683, Washington Decisions, which reiterated certain basic maxims utilized by that Court in interpreting contracts of insurance.

1. It is the established rule in this State that where a provision of insurance is capable of two meanings, or is fairly susceptible of two different constructions, that meaning and construction most favorable to the insured "must be applied", even though the insurer may have intended another meaning (p.686).

2. The language of insurance policies should be interpreted in accordance with its ordinary meaning.

3. Exclusionary clauses in insurance policies are to be "very strictly" construed against the insurer.

There is nothing in the majority opinion indicating that these Washington rules were applied to the instant case. The Missouri Court in the Wendorff case, relied upon by the majority, obviously applied its own rules of construction which are not necessarily identical with the maxims of constructions required in the State of Washington.

In oral argument to the Court, counsel for appellant cited Bruener v. Twin Cities Fire Insurance Co., 37 Wn.(2d) 181, which case had not been listed in appellant's brief. In that case the Washington Court overruled a previous opinion, and adopted what it considered to be the better reasoned rule, i.e., in insurance contract cases "proximate cause" has a

different meaning than when used in tort. It holds that insurance cases are not concerned with why the injury occurred, but only with the nature of the injury (p. 184). Applying this Washington rule to the instant case, the Court should only be concerned with the fact that the insured drowned, and should not be concerned with the causation problem of the circumstances which put him in the water.

To embrace the death of the insured after the aircraft accident, the insurance contract must be expanded by words the parties did not use, and be given a meaning which its words do not impart - incompatible with Washington rules of construction.

SECOND

The main brace in the framework of the majority opinion is Wendorff v. Missouri State Life Insurance Co., 1 S.W.(2d) 99, decided by the Supreme Court of Missouri, 1927, before the McDaniel and Eschweiler decisions of the Seventh Circuit. In Wendorff the exclusion clause read as follows:

> "The insurance hereunder shall not cover injuries fatal or non-fatal . . . sustained by the insured . . . while in or on any vehicle or mechanical device for aerial navigation, or in falling therefrom or therewith or while operating or handling any such vehicle or device." (The underlined portions are not found in appellee's contract of insurance.)

Language in the Wendorff opinion [10] IV, p. 103, makes it appear that the decision of that Court was based upon exclusionary language found in that contract, underlined above, but absent in the instant case.

> ". . . the law would regard drowning as the efficient, predominant cause of death. But a subsequent clause specifically excepts accidental injuries, fatal or nonfatal, sustained in falling from a machine for aerial navigation. If the insured had fallen from

> an airplane to the ground, and been killed, the applicability of the provisions would hardly be questioned, and this without regard to whether the plane was in the air or falling along the ground at the beginning or ending of a flight. We can see no reason why the exception should not be equally binding under the facts here. The ultimate cause of death in the one case would be crushing, in the other it is drowning; but both would result from the same producing cause - falling from a flying machine."

Further, the cases of Walden v. Auto Owners Safety Ins. Co., 311 S.W.(2d) 780 (Ark.), and Wright v. Aetna Life Ins. Co., 10 F.(2d) 281 (Pa.), cited in the majority opinion, are not absolute authorities for interpretation of the word "while", for the reason that both Courts applied the universal rule that language, susceptible of two meanings, shall be construed most favorably to the insured. In both cases the Courts made a liberal construction in finding for the insured. On the other hand, the Court in McDaniel, infra, made a literal construction in finding for the insured.

THIRD

The majority opinion made only passing reference to the two opinions of the United States Court of Appeals for the Seventh Circuit which were more closely in point than any others cited (McDaniel v. Standard Accident Insurance Company, 221 F.(2d) 171, and Eschweiler v. General Accident Fire & Life Assurance Corp. Ltd., 241 F.(2d) 101). Both cases interpret similar language, i.e., "while operating an aircraft." The result is that in the Seventh Circuit a beneficiary prevailed while in the Ninth Circuit, in the instant case, under basically similar facts, the beneficiary failed.

CONCLUSION

For the foregoing reasons, we respectfully urge this Court to grant a rehearing en banc in order to give effect to the decisions of the Supreme Court of the State of Washington and to avoid a different interpretation than that found in the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

WALTER R. RODGERS, III
Attorney for Petitioner

Of Counsel:

RICHTER, RODGERS, WIMBERLEY & ERICSON
708 Old National Bank Building
Spokane, Washington

CERTIFICATE OF ATTORNEY

I, WALTER R. RODGERS, III, Counsel of Record for Petitioner, hereby certify that in my judgment the foregoing Petition for Rehearing is well founded and that it is not interposed for delay.

Dated this 1st day of August, 1963.

WALTER R. RODGERS, III
Attorney for Petitioner

No.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

18271

In the Matter of Extradition of

JAIME J. MERINO

A Fugitive from the Justice of

Mexico.

APPELLANT'S OPENING BRIEF

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MAdison 8-4788

Attorney for Appellant,
Jaime J. Merino

TOPICAL INDEX

Page

TABLE OF AUTHORITIES CITED

TABLE OF AUTHORITIES CITED (Cont'd)

TABLE OF AUTHORITIES CITED (Cont'd)

U. S. Constitution and Statutes

TABLE OF AUTHORITIES CITED (Cont'd)

Rules

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In the Matter of Extradition of JAIME J. MERINO, A Fugitive from the Justice of Mexico	)	No.

APPELLANT'S OPENING BRIEF

The appeal in the instant matter is prosecuted to this Court from an order of the United States District Court for the Southern District of California, Central Division, denying your petitioner an application for a writ of mandate, or in the alternative a motion for an order directing the United States Commissioner, Theodore Hocke to make his order authorizing the taking of depositions in the Republic of Mexico for use in evidence in the extradition proceedings against petitioner, or from an order authorizing the Commissioner to exercice his discretion in determining whether or not defendant should be granted an order authorizing the taking of depositions in

Mexico.

STATEMENT OF JURISDICTION

This Court has jurisdiction to entertain this appeal and review the order in question under the provisions of Section 1291 and 1294, Title 28, U.S.C.A.

The jurisdiction of the United States Commissioner to hear the instant extradition matter is predicated on his order of appointment, dated February 28, 1959.

The jurisdiction of the District Court and the United States Commissioner is based upon Section 3184, Title 18, U.S.C.A. and the Extradition Treaty between the United States and Mexico, ratification exchanged April 22, 1899, proclaimed April 24, 1899, as amended.

The application to the District Court for its writ and order was made subsequent to the final order of the United States Commissioner after hearing under Section 3184, U.S.C.A. on April 23, 1962 and filed April 24, 1962.

The notice of appeal to this Court and the designation of record on appeal, was filed with the District Court on April 27, 1962. Timely notice of the appeal vested jurisdiction with this Court.

PRELIMINARY STATEMENT

A prior application was made to the District Court before the hearings contemplated under Section 3184,

U.S.C.A., Title 18. This motion was denied by the District Court, and on appeal to this Court it was determined that the motion was premature, as no "hearing under Section 3184 has as yet been held". (See Merino vs. Hocke, 289 Fed 2d, 636.)

Since finality has not attached to the orders of the United States Commissioner and the District Court on the appellant's petition, the Court has jurisdiction to review the denial of the District Court of appellant's motions.

STATEMENT OF THE CASE

Complaint in extradition was filed February 1, 1960, amended April 12, 1960, charging in essence that the appellant was duly and legally charged with having committed in the Republic of Mexico the crimes of falsification of the official acts of the Government or public authority and the uttering of fraudulent use of the same; embezzlement of public funds by a public officer or depository, while employed by Petroleos Mexicanos, an alleged agency of the Government of Mexico, in the capacity of Superintendent of the District of Posa Rica, the State of Vera Cruz, Mexico, during the years 1957 and 1958.

The amended extradition complaint further charges that the appellant has been found outside the boundaries of Mexico; that a warrant for the arrest of appellant has

cannot be served in Mexico; that the appellant has sought asylum within the jurisdiction of the United States of America and may be found in the State of California, City of Redondo Beach; and that appellant is not a citizen of the United States of America.

On April 25, 1960, appellant moved the United States Commissioner for the Southern District of California, Central Division, for an order authorizing the taking of depositions of witness in the Republic of Mexico. Said motion came on for hearing before the United States Commissioner on May 26, 1960, and was denied.

In the motion before the United States Commissioner, the appellant sought authority to take depositions of certain individuals domiciled in Mexico. The United States Commissioner denied the motion. The appellant then applied to the United States District Court for a writ of mandamus or, in the alternative, an order in the nature of a writ of mandamus directing the United States Commissioner to make the order or exercise his discretion. These motions were denied and affirmed on appeal. (See Merino v. Hocke, 289 Fed 2d, 636)

The extradition proceedings proceeded to finality before the Commissioner. Subsequent to the entry of his order directing extradition, petitioner moved the District Court for his Orders directed to the Commissioner which were denied on April 24, 1962. Hence this appeal.

to establish an alibi. Judge Brown considered the Act of August 3, 1882, and held that while it was the duty of the Commissioner, under Section 3 of that Act, to take such evidence of oral witnesses as should be offered by the accused, the Statute did not apply testimony obtained upon commission or by deposition, adding that, so far as he was aware, there was no warrant, according to the law or the practice before committing magistrates in the State of New York, for receiving testimony by commission or by the depositions of foreign witnesses taken abroad, and that all the provisions of the law and the statutes contemplared the production of the defendant's witnesses in person before the magistrate for examination by him. The order dismissing the writ of habeas corpus in that case was affirmed by the Circuit Court, held by Judge Wallace in re Wadge, 21 Blatchf. 300. He said:

"'The depositions and proofs presented a sufficient case to the Commissioner for the exercise of his judicial discretion, and his judgment cannot be re-reviewed upon this proceeding. He is made the judge of the weight and effect of the evidence, and this Court cannot review his action, when there was sufficient competent evidence before him to authorize him to decide the merits of the case'".

The authority of Cortez supr is limited "Certificates-- copies of papers-- ex parte depositions" are not admiss-

ble in evidence in extradition proceedings.

This is not the instant problem or issue. Petitioner seeks an order to take depositions under statutory authority and procedure. He does not ask use of "ex parte" documents which are under statutory authority limited to the demanding government. Even though foreign governments may not afford persons accused of crime with our concept of due process of law, and such guarantees are not of concern to our Courts, yet, where extradiction proceedings by a foreign power are brought within the doman of the United States, due process and the guarantee of our criminal procedure must protect those who are thus sought to be extradicted under our law. See:

Holmes v. Jennison, 1840, 14 Pet 540, 39 U.S. 540, 568, 10 L. Ed 579

Grin v. Shine, L. Ed. 130

Ex parte LaMantia, D.C.S.D.N.Y. 1913, 206 F 330

Ex parte Fudera, D.C.S.D.N.Y. 1908, 162, F, 591 Appeal dismissed, 219 U.S. 589, 31 S. Ct. 470, 55 L Ed 348

Gallina v Fraser, 278 F 2d 77

Extradiction proceedings have been referred to by the Supreme Court as being of a criminal nature. See:

Grin v Shine 1902, U.S. 181, 23 S Ct. 98, 47 L. Ed. 130

Rice v Ames, 1901, 180 U.S. 371, 21 S Ct. 406, 45 L Ed. 577.

In Grin v. Shine, supra, the Court said:

"Good faith toward foreigh powers, with which we have

entered into treaties of extradition, does not require us to surrender persons charged with crime in violation of those well-settled principles of criminal procedure which from time immemorial have characterized Anglo-Saxon jurisprudence. Persons charged with crime in foreign countries, who have taken refuge here, are entitled to the same defense as others accused of crime within our own jurisdiction.

* * * * * * * *

SPECIFICATIONS OF ERROR

1) THE DISTRICT COURT ERRED IN DENYING APPELLANT'S APPLICATION IN THE NATURE OF A WRIT OF MANDAMUS COMPELLING THE UNITED STATES COMMISSIONER TO PERMIT APPELLANT TO TAKE DEPOSITIONS IN THE REPUBLIC OF MESICO OR, IN THE ALTERNATIVE, TO COMPEL THE UNITED STATES COMMISSIONER TO EXERCISE HIS DISCRETION IN PERMITTING THE TAKING OF DEPOSITIONS.

Section 3184, Title 18, U.S.C., empowers "any justice or judge of the United States, or any Commissioner authorized so to do by a Court of the United States, or any judge of a Court of record of general jurisdiction of any State" in whose jurisdiction the fugitive is found, to conduct (after apprehension and appearance) a hearing "to the end that the evidence of criminality may be heard and considered. If, on such hearing, he deems the evidence of sufficient to sustain

the charge under the provisions of the proper treaty * * * he shall certify the same, together with a copy of all the testimony taken before him, to the Secretary of State * * *. Neither statues nor decided cases furnish satisfactory guides as to procedures for obtaining proof upon extradition proceedings. However, the Courts have compared these proceedings with -

> "preliminary examinations which take place every day in this country before an examining or committing magistrate for the purpose of determining whether a case is made out which will justify the holding of the accused, either by imprisonment or under bail, to ultimately answer to an indictment, or other proceeding, in which he shall be finally tried upon the charge mad. against him."
>
> Benson v. McMahon, 1888, 127 U.S. 457, 463, 8 S Ct 1240, 1243, 32 L ED 234.

ee First National City Bank of New York vs. Aristeguieta, 287 F 2d 219 (1960)

Rule 5 provides for the proceedings before the United States Commissioner in Criminal Proceedings, which include:

a) Appearance before the Commissioner,

b) Statement by the Commissioner,

c) Preliminary examination.

Rule 15 of the Federal Rules of Criminal Procedure provides for the taking of depositions in criminal cases.

of State * * * . Neither statutes nor decided cases furnish satisfactory guides as to procedures for obtaining proof upon extradition proceedings. However, the Courts have compared these proceedings with

"preliminary examinations which take place every day in this country before an examining or committing magistrate for the purpose of determining whether a case is made out which will justify the holding of the accused, wither by imprisonment or under bail, to ultimately answer to an indictment, or other proceeding, in which he shall be finally tried upon the charge made against him". Benson v. McMahon, 1888, 127 U.S. 457, 463, 8 S Ct. 1240 1243, 32 L. ED 234. See: First National City Bank of New York v. Aristeguieta, 287 F 2d 219 (1960)

Rule 5 provides for the proceedings before the United States Commissioner in Criminal Proceedings, which include:

a) Appearance before the Commissioner,

b) Statement by the Commissioner,

c) Preliminary examination.

Rule 15 of the Federal Rules of Criminal Procedure provides for the taking of depositions in criminal cases. The deposition of a witness may be taken if he is "unable to attend or prevented from attending a trial or hearing, that his testimony is material, that it is necessary to take his deposition in order to prevent a failure of justice * * * ".

The deposition of a witness may be taken if he is "unable to attend or prevented from attending a trial or hearing, that his testimony is material, that it is necessary to take his deposition in order to prevent a failure of justice * * * ".

Sub-division (e) of Rule 15 provides in part, as follow:

(e) "At the trial or upon any hearing, a part of all of a deposition, so far as otherwise admissible under the rules of evidence, may be used if it appears: That the witness is dead; or that the witness is out of the United States, unless it appears that the absence of the witness was procured by the party offering the deposition; or that the witness is unable to attend or testify because of sickness or infirmity; or that the party offering the deposition has been unable to procure the attendance of the witness by subpoena * * *". Clearly a witness outside of the United States could not be subpoened, but his testimony would, of necessity, have to be secured by deposition.

It appears to be well settled that the District Court have supervisory powers over the United States Commissioners appointed to assist said Courts in their judicial functions.

"The Commissioner (in an extradition proceeding) is in fact an adjunct of the Court, possessing independent

though subordinate judicial powers of his own".

Grin v. Shine, 187 U.S. 181, 187 (1902) emphasis supplied.

"The United States Commissioner, being only a ministerial or quasi judicial officer, is always under the supervision and direction of the District Court. His findings may be reviewed by the District Court at any time".

U.S. v. Zerbst, 111 F Sup. 807, 810 (E.D.S.C. 1953)

See U.S. vs. Florida, 165 F. Sup. 328 E.D. Ark. 1958

Since the District Court has general supervisory responsibility over a United States Commissioner, it would seem clear that as part of the District Court s jurisdiction that it has the corollary power to function in this supervisory capacity, whether this power be designated as a power to issue a writ of mandamus or the power to grant appropriate orders.

"The abolition of the writ of mandamus under the provisions of Rule 81 (b, of the Civil Rules for District Courts, 28 USCA following Section 723c, does not qualify or limit the existing statutory jurisdiction since relief heretofore available by mandamus may nevertheless be obtained by other appropriate practice prescribed in the Rules".

++++++++++++++++

"The qualifications to the jurisdiction this con-

ferred limits the jurisdiction of District Courts to the issuance of such writs which may be necessary to the exercise of their respective jurisdictions and agreeable to the usages and principles of law. Under this Section, District Courts may issue writs of mandamus when necessary to the exercise of their jurisdiction but not as original writs in any case".

Patrowski v Nutt, 161 F 2d 938, 939 (9th Cir. 1947) cert. denied 333 U.S. 842, rehearing denied 332 U.S. 882.

"The United States Commissioner is a ministerial-or at best, only a quasi judicial-officer and his acts therefore are subject to review by the District Court.

U.S. v. Zerbst, supr. p. 809

Based on the foregoing authorities, petitioner respectfully submits that it is patently obvious the District Court had inherent power to supervise the granting or denial of his motion before the Commissioner to take depositions in the Republic of Mexico and that any attempt to resolve the issue to one of semantics is simply an attempt to avoid the issue of whether or not appellant was in fact entitled to take such depositions.

PETITIONER'S SHOWING OF NECESSITY FOR AUTHORITY TO TAKE DEPOSITIONS MADE BEFORE THE UNITED STATES COMMISSIONER AND THIS COURT WAS UNREBUTTED AND THEREFORE CANNOT BE CHALLENGED AT THIS TIME.

Attention is respectfully invited to the transcript of record containing the affidavit of BARTON C. SHEELA, Jr. in support of the request to take depositions in

the Republic of Mexico. This affidavit was presented both to the United States Commissioner and to the District Court. It is significant that at no time were the allegations in this affidavit rebutted. An examination of the matters contained therein establishes beyond peradverture that petitioner has demonstrated the necessity of judicial authorization to take the depositions requested. If the parties opposing petitioner's request to take depositions wished to challenge the accuracy of Mr. Sheela's affidavit, the appropriate time to do so would have been either when the matter was being considered by the United States Commissioner or the District Court. Petitioner submits that based on the record filed with this Honorable Court the necessity of taking the requested depositions has been amply demonstrated.

The argument of respondent that taking of depositions would delay the extradition hearing and that certain language difficulties would be involved which would appear to be no more than an attempt to justify the fuling of the Commissioner on a ground on which it was not in fact predicated. As noted, the sole basis upon which the Commissioner denied the request to take depositions was that he was bound by the decision of the Supreme Court in Luis Oteiza y Cortez vs Jacobus, supr. Should it be determined that the Commissioner

in fact had the power to authorize these depositions, then we can be certain that the delays and difficulties mentioned by respondent will be controlled by the Commissioner.

THE CONTENTION THAT THE EVIDENCE SOUGHT TO BE ADDUCED THROUGH DEPOSITIONS REFERS ONLY TO MATTERS OF DEFENSE, IGNORES THE FACT THAT AN EXTRADITION PROCEEDING IS NOT EX PARTE AND THE RESISTING PARTY HAS THE RIGHT TO PRESENT EVIDENCE.

Respondent apparently conceives of an extradition proceeding as being unilateral in that the resisting party may not offer evidence to rebut the showing of probable cause. Attention is respectfully invited to Section 3191, Title 18, U.S. Code, which specifically provides that an indigent party in an extradition proceeding may obtain the presence of "witnesses whose evidence is material to the defense" at government expense. It would appear clear therefore that any argument that evidence to support a finding of probable cause must go unrebutted must be rejected. Petitioner submits that the matters set forth in the affidavit of BARTON C. SHEELA, Jr. clearly demonstrate their materiality to the issue of whether or not there is sufficient evidence which would justify the apprehension and committment for trial of petitioner.

Petitioner specifically directs the court's attention to petitioner's request that he be permitted to take depositions which would show that much of the

evidence produced by the demanding government was the product of threats, promises and coersion. It would seem patently obvious that this evidence would be of real interest to the Commissioner in determining what weight, if any, should be given to the purported testimony contained in the demanding government's papers filed with the Commissioner.

See U.S. v. Artukovich, 170 F Sup. 383, 390 (S.D. Cal. 1959)

****

2) THE DISTRICT COURT ERRED IN DENYING APPELLANT'S MOTION FOR AN ORDER DIRECTING THE UNITED STATES COMMISSIONER TO MAKE AN ORDER AUTHORIZING THE TAKING OF DEPOSITIONS IN THE REPUBLIC OF MEXICO OR, IN THE ALTERNATIVE, TO ORDER THE UNITED STATES COMMISSIONER TO EXERCISE HIS DISCRETION IN DETERMINING WHETHER OR NOT APPELLANT SHOULD BE PERMITTED TO TAKE DEPOSITIONS IN THE REPUBLIC OF MEXICO.

We respectfully content that an international extradiction proceedins, the magistrate and Court have the right and power to authorize the taking of depositions on behalf of the accused. There is, indeed, a strong showing by affidavid of exceptional facts and circumstances which, in the interest of fairness and to "prevent failure of justice", and in the exercise of due process, requres the taking of the deposition. The evidence sought is for the purpose of explaining the charge against the accused and not strictly speaking

a defense to the merits.

The accused may offer "limited evidence admissible under recognized standards to explain elements in the case against him". First National City Bank of New York vs Aristeguieta, 287 F 2d 219 (1960)

> "* * * moreover, Section 3191 provides, as to an indigent fugitive, where "there are witnesses whose evidence is material to his defense" and without whom "he cannot safely go to trial," the magistrate "may order that such witnesses be subpenaed" and the costs incurred and the fees of the witnesses "shall be paid in the same manner as in the case of witnesses subpenaed in behalf of the United States."

A witness may be subpenaed to give testimony by deposition hearing on behalf of the accused. A liberal interpretation of Section 3191 of Title 18, Supra permits and sanctions the obtaining of the testimony either by depositions or personal appearance through the power of the Court or the magistrate to issue its subpoena for such purpose. The appellant herein has promptly and dilligently sought to secure the depositions in this case and has not been dilatory in any particular.

He originally initiated the motion before the hearing magistrate at the inception of the proceedings

before him, which was denied; then sought an order of the District Court to compel the taking of depositions. This being denied, he sought the authority of this Court, which held the application was premature.

Merino v Hocke, 289 F 2d 636

At the conclusion of proccedings before the United States Commissioner, an order was again sought from the District Court. His application to compel the Commissioner to exercise his authority authorizing the taking of deposition or a direct order for the taking of the depositions by the United States District Court was denied by the Court and hence this appeal.

These are not belated efforts of the accused, but prompt and continuous requests which have been denied.

In Benson vs. McMahon, 127 U.S. 457, the Supreme Court in interpreting the identical treaty with Mexico and the nature of the proceedings before the Magistrate declared:

> "Taking this provision of the treaty and that of the Revised Statues above recited 460, we are of opinion that the proceeding before the Commissioner is not to be regarded as in the nature of a final trial by which the prisoner could be convicted or acquitted of the crime charged against him, but rather of the character of those preliminary examinations which take place every day in this country

before an examining or committing magistrate for the purpose of determining whether a case is made out which will justify the holding of the accused, either by imprisonment or under bail, to ultimately answer to an indictment or other proceeding, in which he shall be finally tried upon the charge made against. The language of the treaty which we have cited, above quoted, explicitly provides that the 'commision of the crime shall be so established as that the laws of the country in which the fugitive or the person so accused shall be found would justify his or her apprehension and committment for trial if the crime had been there committed.' This prescrives the proceedings in these preliminary examinations as accurately as language can well do it."

****

3) THE DISTRICT COURT ERRED IN FAILING TO MAKE ITS ORDER TO TAKE THE DEPOSITIONS UNDER THE APPROPRIATE DEPOSITIONS STATUTE OF THE UNITED STATES.

In this matter it is essential that Mr. Merino obtain relevant evidence in Mexico that will establish clearly that there is no reasonable or probably cause to justify his extradition to Mexico.

Certainly the United States Constitution which provides in part "no person can be deprived of life,

liberty or property without due process of law" is ample authority. Recent developments and trends in the field of criminal law in thestate and federal courts indicate that when the interests of justice require, the accused will be permitted rights that have heretofore been denied.

1. Federal cases reflecting a liberal trend are as follows: Mapp vs. Ohio 367 U.S. 643 Jenks v. United States. 353 U.S. 657, which accorded the defendant discovery rights (production of statements) to afford an opportunity to impeach the credibility of government witnesses on cross examination. Refusal to produce on the part of the government requires a dismissal.

Elkins v. United States, 364 U.S. 206, held that evidence obtained by state officers during a search which if conducted by federal officers would have violated the defendant's immunity from unreasonable search and seizure under the Fourth Amendment, is inadmissible over the defendant't timely objection in a federal criminal trial. This decision appears to have overruled Weeks v. United States, 232 U.S. 384 (1914), which held that evidence illegally seized by federal officials in violation of the Fourth Amendment was inadmissible in a federal prosecution. The Court states that no such ex-

clusion should apply in a federal case where the unlawful seizure was by local officials since the Fourth Amendment was not enforceable against the States.

Jones v. United States, 363 U.S. 257 (1960), wherein the defendant, a guest in an apartment who was not required to claim ownership of the drugs in moving to suppress evidence. The Court stated that anyone legitimately on premises where a search occurs may challenge its legality by way of a motion to suppress when its fruits are proposed to be used against him.

2. California cases reflecting this trend are the following:

People v. Riser, 37 Cal. 2d 566, 586, 305 P 2d L (1956), holding that it was error to refuse to compel the production of the statements of prosecuting witnesses and noting that the statements in order to be accessible to the defense need not be signed. The court in its opinion stated:

> "*** Absent some governmental requirement that information be kept confidential for the purpose of effective law enforcement, the state has no interest in denying the accused access to all evidence that can throw light on issues in the case, and in particular it has no interest

in convicting on the testimony of witnesses who have not been as rigorously cross-examined and as thoroughly impeached as the evidence permits. To deny flatly any right of production on the ground that an imbalance would be created between the advantages of prosecution and defense would be to lose signt of the true purpose of a criminal trial, the ascertainment of the fact. ***"

Powell v. Superior Court, 48 C 2d 704, 709, 331P 2 d 698 (1957), stated:

"*** ' *** That it was desired that the state's evidence remain undisclosed, partakes of the nature of a game, rather than judicial procedure. The state in its might and power ought to be and is too jealous of according a defendant a fair and impartial trial to hinder him in intelligently preparing his defense and in availing himself of all competent material and relevant evidence that tends to throw light on the subject-matter on trial.'"

Norton v. Superior Court, 173 C.A. 2d 133, 343P. 2 d 139, granted mandamus to compel the prosecution to display to counsel for the defense photographs of defendant displayed to three robbery victims, and further ordered that defendant be supplied with

the names and addresses of witnesses to the offense with which defendant was charged.

Funk v. Superior Court, 52 C. 2d 423, 340 P 2 d 593 (1959), held that defendant was entitled prior to the trial to recorded statements and to written statements prepared by investigators concerning conversations with prosecution witnesses.

Schindler v. Superior Court, 161 C.A. 2d 513, 327 P 2d 68 (1958), in addition to compelling the inspection of statements made by defendant, held that counsel for the defense was entitled to examine tissue specimens taken by an autopsy surgeon where examination of such was material to the cause of death of the victim.

See also Walker v. Superior Court, 155 C.A. 2d 134, 317 P. 2d 130 (3rd. Dist., 1957).

People vs. Chapman, 52 C 2d 95, 338 P. 2d 428 (1959), held it error to refuse to produce written statements prepared by the police and signed by the principal prosecution witness.

3. The appellant submits on the basis of the following that the court below erred:

Title 18, United States Code, Sectin 1651a, states:

> "The Supreme Court and all courts established by act of Congress may issue all writs necessary in aid of their respective jurisdictions and

agreeable to the usages and principles of law."

See also Hammond v. Hull, 131 F ed 23, 25 (C.A. D.C. , 1942) (Cert. denied 318 U.S. 777), which noted in an action for declaration of plaintiff's rights as a foreign servoce pffocer. that the remedy formally known as mandamus was still available under the new Rules of Civil Procedure.

Grier v. Kennen, 64 2d 605 (8th Cir., 1933), held that an application to the United States District Court for a writ of mandamus compelling the United States Commissioner to entertain a hearing under former Section 641 of Title 18, U.S.C. (now Title 18, U.S.C., Section 3569), as to the ability of the petitioner to pay a fine was the proper remedy to compel the Commissioner to conduct such a hearing.

United States v. Dockery, 50 F Supp. 410 (E.D.N.Y. 1943), held that the United States District Court has inherent power to permit the taking of depositions outside of the United States in order to prevent an injustice (but holding that there was an insufficient showing under the facts there presented).

United States vs. U. S. District Court, 238 F 2d 813 (4th Cir., 1956) (cert. denied 352 U.S. 981),

held that the Circuit Court had power under the "all writs section" (28 U.S.C., Section 1651a) to issue a writ of mandamus to compel the District Court Judge to vacate an order quashing certain subpoenas duces tecum for production of documents before a Federal Grand Jury and also to vacate certain other orders of the Judge.

Paramount Pictures v. Rodney, 186 F 2d 111 (3rd Cir., 1951) (Cert. denied 340 U.S. 953) held that mandamus was the proper remedy to compel a District Court Judge to exercise his discretion in passing on a motion to transfer certain suits under Title 28, U.S.C., Section 1404a, for the convenience of parties and witnesses where the District Court had ruled it had no power to transfer the cause.

Rule 12, Federal Rules of Criminal Procedure, states:

> "If it appears that a prospective witness may be unable to attend or is prevented from attending a trial or hearing, that his testimony is material and that it is necessary to take his deposition in order to prevent failure of justice the court at any time after the filing of an indictment or information may upon motion of a defendant and notice to the parties, order that his testimony be taken by deposition and that any designated books, papers, documents or

tangible objects, not privileged, be produced at the same time and place. ***"

See Luxemberg v. United States, 45 F 2d 497 (4th Cir. 1930) (cert. denied 283 U.S. 820)

Compare Wong Yim v. United States, 118 F 2d 667 (9th Cir., 1941 (cert. denied 313 U.S. 589).

Title 18, United States Code, Section 3191, states:

"On the hearing of any case under a claim of extradition by a foreign government, upon affidavit being filed by the person charged setting forth that there are witnesses whose evidence is material to the defense, that he cannot safely go to trial without them, what he expects to prove by each of them, and that he is not possessed of sufficient means, and is actually unable to pay the fees of such witnesses, the judge or commissioner hearing the matter may order that such witnesses be subpoenaed, and the costs incurred by the process and the fees of the witnesses, shall be paid in the same manner as in the case of witnesses subpoenaed in behalf of the United States."

Title 28, United States Code, Section 1781, states:

"Whenever a court of the United States issues letters rogatory or a commission to take a

deposition in a foreign country, the foreign court or officer executing the same may make return thereof to the nearest United States minister or consul, who shall endorse thereon the place and date of his receipt and any change in the condition of the deposition, and transmit it to the clerk of the issuing court in the manner in which his official dispatches are transmitted to the United States Government."

Rule 26, Federal Rules of Civil Procedure, states:

"The deposition of a person confined in prison may be taken only be leave of court on such terms as the court prescribes."

See also, United States v. Artukovich, 170. Supp. 383, 393 (S.D. Cal. 1959)

The following authorities concern documents obtained ex parte by a party resisting extradition:

Luis Oteiza y Cortez v. Jacobus, 136 U.S. 330 1890); United States v. Artukovich, supra.

****

4) THAT THE DISTRICT COURT ERRED IN DETERMINING THAT IN RE LUIS OTEIZA y CORTEZ (1890) 136 U.S. 330, DENIED THE RIGHT OF APPELLANT TO TAKE DEPOSITIONS IN SUPPORT OF HIS DEFENSE.

Both the Commissioner and the District Court predicated their denial of petitioner's right to take de-

positions by approved statutory procedure on the authority of Cortez v. Jacobus, 136 U.S. 330. It is our contention that this decision is not authority for the proposition propounded.

By dictum, it may be, but dictum does not establish law. The petitioner in that case sought to introduce ex parte statements and depositions and the ruling expounded held that such documents were not admissible. This is a far cry from petitioner's position in these proceedings.

We propose to take depositions in the Republic of Mexico under statutory authority which accords the demanding Government the right to be heard on application with respect to relevancy and materiality. If it should be determined by the lower Court that some of the testimony of the witnesses sought to be elicited, is not relevant to the issue of probable cause, the Court may so rule. Regardless, a denial as matter of law that all evidence by deposition are not available to the fugitive, is contrary to our concept of due process to which the accused is entitled.

An examination of the record as designated and filed with this Honorable Court establishes beyond peradventure that when the United States Commissioner and the District Court denied appellant's motion

to take depositions in the Republic of Mexico, the Commissioner predicated his denial on the ground that he was bound by the decision of the Supreme Court in Luis Oteiza y Cortez v. Jacobus, 136 U.S. 330 (1890). Attention is invited to page 7 of the Transcript of Record setting forth the affidavit of Peter J. Hughes presented before the United States District Court in support of the matters from which appeal has been taken, which affidavit stated in pertinent part:

> "The Honorable Theodore Hocke denied said motion for an order authorizing the taking of depositions and that the sole ground upon which said denial was predicated by Commissioner Hocke was that he was bound by the decision of the United States Supreme Court in Luis Oteiza y Cortez v. Jacobus, 136 U.S. 330 (1890)"

The District Court's opinion held likewise. This affidavit was not rebutted by appellee.

Appellant submits that based on the record as lodged with this Honorable Court, it is patently obvious that the United States Commissioner failed to either grant appellant's motion to take depositions in the Republic of Mexico or to exercise his discretion as to whether or not appellant shoule be allowed to take such depositions on the ground that

the Commissioner was precluded from granting such a request. It is submitted that the instant appeal therefore is controlled by the case of Paramount Pictures v. Rodney, 186 F 2d 111 (3rd Cir., 1951) where the lower court erroneously held that it lacked power to grant certain relief. Mandamus was held to be a proper remedy in that situation.

****

5) THAT THE DISTRICT COURT ERRED IN DETERMINING THAT DEPOSITIONS WERE UNAVAILABLE TO THE DEFENSE IN EXTRADITION PROCEEDINGS AND DENIED THE RIGHT TO APPELLANT TO TAKE DEPOSITIONS BY THE WAY OF A SUBPENA IN A FOREIGN COUNTRY, UNDER TITLE 18, U.S.C. , SECTION 3191.

See Points and Authorities under 1, 2, 3, 4, Supra.

****

6) THAT THE DISTRICT COURT ERRED IN DETERMINING THAT EITHER UNDER RULE 15 OF THE FEDERAL RULES OF CRIMINAL PROCEDURE OR RULE 26, FEDERAL RULES OF CIVIL PROCEDURE, WERE NOT APPLICABLE TO EXTRADITION PROCEEDINGS.

See Points and Authorities under 1, 2, 3, 4, Supra.

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7) APPELLANT WAS DENIED DUE PROCESS OF LAW.

The Courts of California and of the United States have uniformily held that preliminary examinations

must accord persons accused of crime with due process of law and established vested rights and procedure.

> "The forms of procedure required by law in preliminary examinations establish a substantial right vested in every person charged with crime and should not be lightly waved aside. People v. Weatherford, 27 Cal. 2d 401 (164 P 2d 753).
>
> A legal preliminary examination is one of the steps required to establish due process of law where the prosecution in the Superior Court is by information and is necessary to confer jurisdiction on that Court."
>
> People v. Brooks, 72 C.A. 2d, 657; 165 P 2d 51
>
> In re Williams, 52 Cal. Ap. 566
>
> People v. Elliot, 54 C 2 498

In this matter, it is essential that Mr. Merino obtain relevant evidence in Mexico, to explain the charge against him, in order that he may establish a lack of reasonable or probably cause to justify his extradiction to Mexico. To deny the accused the right to produce evidence within limited confines accorded a fugitive in extradiction proceedings by way of deposition is, in effect, a denial of due process of law and would sanction "a failure

of justice". The United States Constitution, which provides that: "No person can be deprived of life, liberty, or property without due process of law ...." is a fundamental requirement in extradiction.

Enlightened concept in the interpretation of "due process", both in State and Federal criminal procedure, indicate that, where justice requires, the accused shall now enjoy the rights which had previously been denied him.

In Collins v. Loisel, 259 U.S. 309, 42 Sup. Ct. 469 (1921), the Supreme Court held that testimony or evidence in the form of explanations of ambiguity or doubtful elements in the prima facie case against the accused bearing on the issue of probable cause was proper and appropriate. In Charlton v Kelly, 229 U.S. 477, 33 Sup. Ct. 945 (1912), the Court held that the exclusion by the extradition magistrate of evidence dealing with affirmative defenses constitutes mere harmless error but, in so holding, the Court enunciated that 18 U.S.C. §3191, relating to defense depositions, applied materially in so far as it related to evidence bearing upon the issue of probable cause. Section 3191 provides:

"On the hearing of any case under a claim of

extradition by a foreign government, upon affidavit being filed by the person charged setting forth that there are witnesses whose evidence is material to his defense, that he cannot safely go to trial without them, what he expects to prove by each of them, and that he is not possessed of sufficient means, and is actually unable to pay the fees of such witnesses, the judge or commissioner hearing the matter may order that such witnesses be subpoenaed and the costs incurred by the process, and the fees of witnesses, shall be paid in the same manner as in the case of witnesses subpenaed in behalf of the United States. June 25, 1948, c 645, 62 Stat. 825." (Emphasis supplied.)

The Supreme Court in Charlton v. Kelly, Supra, stated at page 949:

"To have witnesses produced to contradict the testimony for the prosecution is obviously a very different thing from hearing witnesses for the purpose of explaining matters to by the witnesses for the government.

It is the position of appellant that when the Commissioner and District Judge did not permit the taking of the depositions, the appellant could not as a result of the denial "safely go to trial" in the committment proceedings. This was not a mere harmless error in the proceedings but denial of due process and palpable error, requiring a remand of the proceedings for the purpose of allowing the depositions.

Respectfully submitted,

DAVID C. MARCUS

CERTIFICATE OF COUNSEL

STATE OF CALIFORNIA)
) ss
COUNTY OF LOS ANGELES)

I, DAVID C. MARCUS, one of the attorneys for the above named appellant, JAIME J. MERINO, do certify that I have examined the provisions of Rule 18 and 19 of the above entitled Court, and that in my opinion the tendered brief on behalf of the petitioner conforms to all requirements.

DATED: April 1, 1963.

David C. Marcus

DAVID C. MARCUS

STATE OF CALIFORNIA)
) ss
County of Los Angeles)

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and employed in the County of Los Angeles, over the age of eighteen years and not a party to the within action or proceeding; that

My business address is 215 West Fifth Street, Los Angeles 13, California, that on April , 1963, I served the within APPELLANT'S OPENING BRIEF - In the Matter of Extradition of Jaime J. Merino, a Fugitive from the Justice of Mexico - on the following named party by depositing the designated copies thereof, inclosed in a sealed envelope with postage thereon fully prepaid in the United States Post Office in the City of Los Angeles, California, addressed to said party at the address as follows:

United States Attorney
Southern District of California
Sixth Floor Federal Building
Los Angeles, California

3 copies

I declare under penalty of perjury that the foregoing is true and correct.

Executed on April , 1963, at Los Angeles, California.

D. A. Mandell
Signature

No. 18271

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAIME J. MERINO,

Appellant,

vs.

THEODORE HOCKE, United States Commissioner,

Appellee.

APPELLEE'S BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

No. 18271

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAIME J. MERINO,

Appellant,

vs.

THEODORE HOCKE, United States Commissioner,

Appellee.

APPELLEE'S BRIEF.

I.

JURISDICTIONAL STATEMENT.

This is an appeal from the order of the United States District Court for the Southern District of California, denying an application for a writ of mandamus and, in the alternative, an order, each providing for directions to United States Commissioner Theodore Hocke that he make an order authorizing the taking of depositions in Mexico by appellant for introduction in evidence in extradition proceedings and that he exercise his discretion in determining whether such an order should be granted.

The jurisdiction of United States Commissioner Hocke to hear extradition matters is based on said

Commissioner's Order of Appointment, dated February 28, 1959.

The jurisdiction of the District Court and said United States Commissioner was based upon Section 3184 of Title 18, United States Code, and the extradition treaty existing between the United States of America and the Republic of Mexico, ratification exchanged April 22, 1899, proclaimed April 24, 1899, as amended.

Appellant maintains that this court has jurisdiction to entertain this appeal and to review the order in question under the provisions of Sections 1291 and 1294, Title 28, United States Code.

II.

STATEMENT OF THE CASE.

On February 1, 1960, an extradition complaint was filed with the United States Commissioner, Los Angeles against appellant herein. On April 12, 1960, an amended complaint was filed, setting forth the basis for extradition proceedings, including the fact that appellant was not a citizen of the United States.

The amended complaint also alleged in essence that appellant had sought asylum in the United States and was in the United States and had been duly and legally charged with having committed in Mexico the crimes of embezzlement of public funds and falsification of official acts and uttering or fraudulent use of the same.

On April 25, 1960, appellant moved the United States Commissioner for the Southern District of California

for an order authorizing the taking of depositions of certain persons in Mexico. Said motion came on for hearing before the United States Commissioner on May 26, 1960, and was denied.

On July 7, 1960, appellant sought relief from the United States Commissioner's order denying the above-mentioned motion by filing an application for a writ of mandamus and, in the alternative, a motion for an order, before the United States District Court for the Southern District of California, Central Division. The application and motion were denied on July 12, 1960. Notice of Appeal was served by appellant on July 15, 1960. The appeal was dismissed by this Court on April 26, 1961, in *Merino v. Hocke,* 289 F. 2d 636 (9th Cir. 1961).

On December 27, 1961, appellant made the application for writ of mandamus and for an order which were denied on April 27, 1962, and are the subjects of the instant appeal. Notice of appeal was filed on April 27, 1962.

On June 12, 1961, Commissioner Theodore Hocke, Los Angeles, entered an order finding appellant extraditable. Appellant filed a Petition for Writ of Habeas Corpus on June 21, 1961. The United States District Court entered an Order Dismissing Writ of Habeas Corpus on April 3, 1963. Appellant filed notice of appeal from this order on April 11, 1963.

III.
ERROR SPECIFIED.

Appellant has specified the following points on appeal (Appellant's Opening Brief, Topical Index):

1. The Court erred in denying appellant's application in the nature of a writ of mandamus.

2. The Court erred in denying appellant's motion for an order.

3. The Court erred in failing to make an order to take depositions under a United States deposition statute.

4. The Court erred in determining that depositions were unavailable and in denying the right to take depositions "by way of a subpoena" under Title 18, United States Code, Section 3191.

5. The Court erred in determining that neither Rule 15, *Federal Rules of Criminal Procedure,* nor Rule 26, *Federal Rules of Civil Procedure,* was applicable to extradition proceedings.

6. The Court denied due process of law.

IV.
STATEMENT OF THE FACTS.

Basically, the case involves a proceeding for extradition of appellant, a Mexican citizen, from the United States to Mexico. Appellant contends that he should have had the opportunity to present certain evidence during the extradition hearing and that this should have been provided by an order by the United States Commissioner in Los Angeles, authorizing the taking of depositions of certain alleged witnesses in Mexico.

V.

ARGUMENT.

A. This Court Lacks Jurisdiction to Entertain the Instant Appeal.

Except for a few exceptions not material here, the right to appeal is limited to the situations authorized by Title 28, United States Code, Sections 1291 and 1292.

Wallace Products v. Falco Products, 242 F. 2d 958 (3rd Cir. 1957).

See:

Merino v. Hocke, 289 F. 2d 636 at 638 (9th Cir. 1961).

Section 1292 of Title 28 is limited to certain aspects of cases involving injunctions, receiverships, admiralty matters, and patent infringements, as well as certain cases in which a district judge states that he has the opinion that his order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation.

The instant case does not fall within any of the subdivisions of Section 1292. Consequently, the right to appeal depends upon the applicability of Title 28, Section 1291, which reads as follows:

> "The courts of appeals shall have jurisdiction of appeals from all *final decisions* of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court

> of the Virgin Islands, except where a direct review may be had in the Supreme Court." (Emphasis added).

Thus the question is whether the order appealed from was a "final decision." The order was a denial of an application for a writ of mandamus or order requiring a Commissioner's order "authorizing the taking of depositions" in Mexico (or in the alternative, the exercise of the Commissioner's discretion to determine whether he should grant an order "authorizing" the same).

The depositions presumably were desired for use in the extradition hearing, but the hearing was completed before the application was made to the district court for the writ of mandamus or order.

The district court order which is the subject of this appeal was not a "final decision" because it involved only a fragment of the entire proceeding. The basic controversy is presently embraced in appellant's *third* appeal, which is an appeal from the Order Dismissing Writ of Habeas Corpus, an attempted review of all aspects of the extradition hearing.

> "A case may not be brought up in fragments, but the decision appealed from must be final and complete, as to the subject-matter and as to the parties."
>
> *Cole v. Rustgard,* 68 F. 2d 316, at 316 (9th Cir. 1933).

Appellant's situation is essentially no different than it would have been if he had obtained the depositions and then was not permitted to introduce them into evi-

dence. In other words, appellant is essentially attempting to attack the equivalent of an *evidentiary* ruling by the trier of fact, *i.e.,* the Commissioner. However, a litigant may not appeal each adverse evidentiary ruling separately and by itself. Such a rule would permit hundreds of appeals in a lengthy case, imposing an intolerable burden upon the courts, interminable delays, and an overwhelming advantage to the litigant enjoying a financial superiority over his antagonist.

> "It is well settled that a case may not be brought here by writ of error or appeal in *fragments;* that to be reviewable a judgment or decree must be not only final, but complete, that is, *final* not only as to all the parties, but *as to the whole subject matter and as to all the causes of action involved;* and that if the judgment or decree be not thus final and complete, the writ of error or appeal must be dismissed for want of jurisdiction."
>
> *Arnold v. Guimarian & Co.,* 263 U. S. 427, at 434 (1923) (Emphasis added).

"Since the right to a judgment from more than one court is a matter of grace *and not a necessary ingredient of justice,* Congress from the very beginning has, *by forbidding piecemeal disposition on appeal of what for practical purposes is a single controversy,* set itself against enfeebling judicial administration. Thereby is avoided the obstruction to just claims that would come from permitting the harassment and cost of a succession of separate appeals from the various rulings to which a litigation may give rise, from its initiation to entry of judgment. To be effective, judicial ad-

> ministration must not be leaden-footed. Its momentum would be arrested by permitting separate reviews of the component elements in a unified cause. These considerations of policy are especially compelling in the administration of criminal justice. *Not until 1889 was there review as of right in criminal cases.*"
>
> *Cobbledick v. United States,* 309 U. S. 323, at 325 (1940). (Emphasis added)

Since appellant is concerned with a restriction upon his right to gather evidence, his situation is analogous to that of the litigant who unsuccessfully attempts to obtain a subpoena or compel production of books and documents or to obtain a physical examination. However, court orders interfering with these evidentiary quests are not appealable "final decisions."

> "It is perfectly clear that *a refusal to issue* a subpoena duces tecum or a refusal to quash one already issued is not an appealable decision."
>
> *National Nut Co. of California v. Kelling Nut Co.,* 134 F. 2d 532, at 533 (7th Cir. 1943). (Emphasis added.)

> "It is well settled that an order granting or *denying* a subpoena duces tecum for records and documents of a party bearing upon issues relevant in a pending action is not appealable."
>
> *Thomas French & Sons v. International Braid Co.,* 146 F. 2d 735, at 737 (5th Cir. 1945). (Emphasis added).

Denials of applications to compel production of books and documents or for leave to make a physical examination or for a *subpoena duces tecum* involve orders which are interlocutory, *not final.*

> *Cogen v. United States,* 278 U. S. 221, at 223-224 (1929).

An order *supressing the taking of depositions* is not an appealable final order.

> *Carolina Power and Light Company v. Jernigan,* 222 F. 2d 951 (4th Cir. 1955), cert. denied, 350 U. S. 837 (1955).

Appeal of these essentially evidentiary rulings merely serves to impose a needless burden upon courts and litigants.

> "A case may not be brought here by appeal or writ of error in fragments. To be appealable the judgment must be not only final, but complete [citing cases]. And the rule requires that the judgment, to be appealable, should be final not only as to all the parties, but as to the whole subject-matter and as to all the causes of action involved [citing cases]."
>
> *Collins v. Miller,* 252 U. S. 364, at 370 (1920).

To summarize, since the appeal does not attack a "final decision" and is not authorized by statute, it is respectfully submitted that this Court lacks jurisdiction and the appeal should be dismissed.

B. The Instant Appeal Involves No Question Affecting Appellant's Rights.

Appellant attempted to obtain a writ of mandamus directing the United States Commissioner, Los Angeles, California, to

> "(a) Make an order *authorizing* the taking of depositions in the Republic of Mexico by attorneys for the said Jaime J. Merino . . . and in the alternative,
>
> "(b) Exercise his discretion in determining whether or not the said Jaime J. Merino should be granted an order *authorzing* the taking of depositions in the Republic of Mexico."

In the alternative appellant attempted to obtain an order directing the Commissioner to perform the acts described in (a) and (b), above.

It would be gilding the lily to elaborate upon the obvious fact that a United States Commissioner in Los Angeles has no authority to require depositions in Mexico. Perhaps this is why appellant did not request an order *requiring* testimony at depositions to be taken in Mexico. Witnesses could refuse to attend, and the Commissioner could not compel them to attend.

However, appellant requested an order "authorizing" the taking of depositions. It is obvious that if the Commissioner had committed this idle act and authorized the taking of depositions, the legal situation of the parties would remain unchanged. The intended witnesses in Mexico could refuse to attend, just as effectively as they could refuse in the absence of a Commissioner's "authorization." The order requested by

appellant would then be no more effective than King Canute's command to the ocean tides to stop coming in.

Thus appellant cannot complain that the order was not made, because he suffered no harm. The appeal from the order of the district court contains an unmistakable aura of frivolity.

C. An Accused May Not Present Testimony by Foreign Witnesses in Extradition Proceedings.

In the unlikely event that this Court shall reach the merits of appellant's contention, it should be noted that the United States Supreme Court has already ruled upon the question which appellant attempts to raise and has held that there is no authority for receiving depositions of witnesses taken abroad.

> *Oteiza Y. Cortes v. Jacobus,* 136 U. S. 330, at 336-337 (1890).

It is interesting to note that while appellant attempts to raise an argument relating to due process of law under the United States Constitution, he is requesting more than the law permits for defendants in Federal criminal cases in the United States. A search of Federal statutes and rules reveals no authority for testimony by deposition at a preliminary examination, which is the nearest equivalent to an extradition proceeding. Rule 15(a) of the *Federal Rules of Criminal Procedure* provides for defense depositions under certain situations in the course of Federal prosecutions, but the Rule provides that the appropriate motion must be made "after the filing of an indictment or information. . . ." This precludes use of defense depositions at preliminary examinations.

Thus appellant, an alien, argues that it is a violation of due process of law to refuse to extend to him unusual privileges which are not enjoyed by citizens of the United States charged with the most serious Federal crimes!

An extradition proceeding does not involve a full presentation of all of the evidence.

> "To demand such evidence would be unjust to the fugitive, since it would amount to trying him twice for the same offence, and would send him before the foreign tribunals for trial under the adverse presumptions of a former conviction."
>
> 1 *Moore on Extradition,* p. 518.

> "In *In re Wadge,* 15 Fed. 864, 866, cited with approval in Charlton v. Kelly, supra, 461, the right to introduce evidence in defense was claimed; but Judge Brown said: 'If this were recognized as the legal right of the accused in extradition proceedings, it would give him the option of insisting upon a full hearing and trial of his case here; and that might compel the demanding government to produce all its evidence here, both direct and rebutting, in order to meet the defense thus gathered from every quarter. The result would be that the foreign government, though entitled by the terms of the treaty to the extradition of the accused for the purpose of a trial where the crime was committed, would be compelled to go into a full trial on the merits in a foreign country, under all the disadvantages of such a situation, and could not obtain extradition until after it had procured a conviction

of the accused upon a full and substantial trial here. . . .'"

Collins v. Loisel, 259 U. S. 309, at 316 (1922).

Extradition rules differ from the ordinary rules of criminal procedure. This is because the proceeding involves the vital interest of a foreign sovereign, the obligation of the United States Government to the foreign sovereign, and the potential effect, as a precedent, upon the interest of the United States when, with roles reversed, it may be seeking extradition. Solemn treaty obligations are involved which color every aspect of the proceeding.

In a unanimous decision the United States Supreme Court expounded upon the philosophy of extradition proceedings:

> "In the construction and carrying out of such treaties *the ordinary technicalities of criminal proceedings are applicable only to a limited extent.* Foreign powers are not expected to be versed in the niceties of our criminal laws, and proceedings for a surrender are not such as put in issue the life or liberty of the accused. *They simply demand of him that he shall do what all good citizens are required, and ought to be willing to do, viz., submit themselves to the laws of their country.* . . . Presumably at least, no injustice is contemplated, and a proceeding which may have the effect of relieving the country from the presence of one who is likely to threaten the peace and

good order of the community *is rather to be welcomed than discouraged.*"

Grin v. Shine, 187 U. S. 181, at 184-185 (1902) (Emphasis added).

Speaking for another unanimous court, Justice Holmes stated:

"It is common in extradition cases to attempt to bring to bear all the factitious niceties of a criminal trial at common law. *But it is a waste of time.*"

Glucksman v. Henkel, 221 U. S. 508, at 512 (1911) (Emphasis added).

In a later opinion the Supreme Court emphasized the effect of extradition proceedings upon the problem of reciprocity:

"Considerations which should govern the diplomatic relations between nations, and the good faith of treaties, as well, require that their obligations should be liberally construed so as to effect the apparent intention of the parties to secure equality and reciprocity between them." (at p. 293). The Court added:

"The obligation to do what some nations have done voluntarily, in the interest of justice and friendly international relationships, see 1 Moore, Extradition, § 40, should be construed more liberally than a criminal statute or the technical requirements of criminal procedure."

Factor v. Laubenheimer, 290 U. S. 276, at 298 (1933).

Since the extradition proceeding does not involve a trial, there are definite limitations upon the right of the accused to present evidence. The committing magistrate is concerned with the question whether there is evidence justifying extradition. He does not decide the question of innocence or guilt.

> *Collins v. Loisel, supra,* 259 U. S. 309, at 314-15 (1922).

The defendant cannot introduce evidence contradicting the demanding country's proof, establishing an alibi, showing insanity, or showing that the statute of limitations has run.

> *First National City Bank of New York v. Aristeguieta,* 287 F. 2d 219, at 226-27 (2nd Cir. 1960), cert. granted, 365 U. S. 840 (1961).

He is not entitled to introduce evidence which merely goes to his defense.

> *Jimenez v. Aristeguieta,* 311 F. 2d 547 (5th Cir. 1962).

He may not raise the defense of statute of limitations.

> *Hatfield v. Guay,* 87 F. 2d 358, at 364 (1st Cir. 1937), cert. denied, 300 U. S. 678 (1936).

In *Desmond v. Eggers,* 18 F. 2d 503 (1927), this Court upheld the act of an extradition committing magistrate in refusing to hear the accused's evidence that he was not in the foreign nation at the time of the commission of the alleged offense. A motion for stay of execution was denied. 274 U. S. 722 (1927).

A defendant does not have the right to procure depositions from a foreign country tending to show an alibi.

In re Wadge, 15 Fed. 864 (S. D. N. Y. 1883).

Even in the rare case in which an accused is allowed to present evidence at an extradition hearing, the wrongful exclusion of that evidence does not render the detention illegal.

Collins v. Loisel, supra, 259 U. S. 309, at 316 (1922).

Appellant cites Rule 15 of the *Federal Rules of Criminal Procedure,* providing for depositions in Federal criminal cases. However, the *Federal Rules of Criminal Procedure* are not applicable to extradition proceedings.

Rule 54(b)(5), *Federal Rules of Criminal Procedure.*

It appears that appellant is attempting to incorporate Rule 15 upon the basis of a statement in *Benson v. McMahon,* 127 U. S. 457, at 463 (1888), comparing extradition proceedings with preliminary examinations, and a statement in *Grin v. Shine, supra,* 187 U. S. 181, at 184 (1902), to the effect that extradition defendants have "the same defenses as others accused of crime within our own jurisdiction."

However, *Benson* merely repeated the oft-stated rule[1] that extradition proceedings are similar to *state* criminal proceedings.

---

[1]Now open to some question, see *Application of D'Amico,* 185 F. Supp. 925 (S.D.N.Y. 1960).

See:

Wright v. Henkel, 190 U. S. 40, at 59 (1903);
Charlton v. Kelly, 229 U. S. 447, at 456 (1913);
Collins v. Loisel, supra, 259 U. S. 309, at 315 (1922).

Benson referred to *state* procedural rules, and Rule 15 of the *Federal Rules of Criminal Procedure* has nothing to do with state preliminary examinations. Furthermore, if the language in *Benson* ever sanctioned a procedure by which Rule 15 could be applicable to extradition proceedings, which is not conceded, then Rule 54(b)(5) subsequently altered the situation.

While *Grin* states that accused fugitives have the same defenses as others accused of crimes, it also holds (at p. 184) that "*the ordinary technicalities of criminal proceedings are applicable only to a limited extent.*" Furthermore, it is well to note the defenses of "others accused of crime within our own jurisdiction." There is no absolute right to a preliminary examination, as there may be an indictment in lieu of preliminary examination.

Boone v. United States, 280 F. 2d 911 (6th Cir. 1960).

In *Charlton v. Kelly, supra,* 229 U. S. 447, at 462 (1913), in rejecting an accused's argument that he should have been allowed to present evidence in extradition proceedings, the Supreme Court mentioned the somewhat analogous rights of American defendants in grand jury proceedings:

"A defendant *has no general right to have evidence exonerating him go before a grand jury,*

> and unless the prosecution consents, *such witnesses may be excluded.*"

It is apparent that appellant rests his case upon Rule 15, rather than any alleged common-law right to obtain depositions. Appellant states: "Petitioner seeks an order to take depositions under *statutory* authority and procedure." Appellant's Opening Brief, page 7 (emphasis added). However, for the reasons mentioned above, Rule 15 does not provide that authority.

D. Even if the Accused Had the Right to Obtain Foreign Depositions, Denial of That Quest Is Not Subject to Review.

It is not conceded that appellant had the right to obtain foreign depositions. However, if he had the right, the denial thereof had no greater effect than a ruling excluding evidence. As noted above, wrongful exclusion of evidence in extradition proceedings does not render the detention illegal.

> "It is clear that the mere wrongful exclusion of specific pieces of evidence, *however important,* does not render the detention illegal."
>
> *Collins v. Loisel, supra,* 259 U. S. 309, at 316 (1922), (emphasis added).

In the recent 1962 decision in *Jimenez v. Aristeguieta, supra,* 311 F. 2d 547, at 556, the 5th Circuit ruled that the committing magistrate *need not read defense testimony introduced* by exhibit, which was the chief source of evidence in that case.

The Government submits that refusal to *allow* depositions would be no more erroneous than refusal to *read* depositions.

E. The Order Which Appellant Requested From the District Court Would Have Had No Legal Effect if Granted.

After the Commissioner found appellant extraditable, appellant moved the District Court for the writ of mandamus or order involved in the instant appeal, directing the Commissioner to authorize the taking of depositions, etc. If the writ or order had been granted and appellant had taken depositions, what would he do with them? The extradition hearing had been completed. The writ or order would have had no legal effect. If, by some unusual legal theory, appellant hoped to have the proceedings reopened, he failed to make such a request. If the District Court committed error, which is not conceded, appellant's rights were not affected. There being no injury, the appeal is not meritorious.

F. Appellant Had No Right to Depositions Under 18 U. S. C. A. 3191 or Rule 26, Federal Rules of Civil Procedure.

Appellant contends that he had the right to obtain depositions under Title 18, United States Code, Section 3191. Section 3191 requires an affidavit to the effect that the accused is an indigent. No such affidavit was filed in the instant case, so Section 3191 is not applicable.

Appellant's argument is identical to the contentions rejected in the recent *Jimenez* decision, *supra,* in which it was held that Section 3191 of Title 18 does not ap-

ply to depositions, as it is concerned only with subpoenas.

> *Jimenez v. Aristeguieta, supra,* 311 F. 2d 547 (5th Cir. 1962).[2]

Jimenez also holds that the provisions of Section 3190 of Title 18 (foreign depositions) do not apply to defense attempts to obtain depositions.

Appellant also cites Rule 26 of the *Federal Rules of Civil Procedure.* It does not appear that appellant raised this point in his memorandum of "Points and Authorities" filed herein with the District Court in April, 1962. A matter not presented to a lower court should not be considered upon appeal.

> *Libbey-Owens-Ford Glass Co. v. Sylvania Indust. Corp.,* 154 F. 2d 814, at 816 (1946), cert. denied, 328 U. S. 859 (1946).

Furthermore, it is highly doubtful that the *Rules of Civil Procedure* apply in extradition proceedings. Appellant's Opening Brief (p. 7) states that extradition proceedings have been referred to by the Supreme Court as being of a *criminal* nature (citing cases). It would be a patent inconsistency to apply the Federal Rules of *Civil* Procedure to a *criminal* case.

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[2]In connection with this argument appellant adds observations regarding his diligence in attempting to secure depositions: "The appellant herein has promptly and diligently sought to secure the depositions in this case and has not been dilatory in any particular." (Appellant's Opening Brief, p. 17.) Again: "These are not belated efforts of the accused, but prompt and continuous requests which have been denied." (Appellant's Opening Brief, p. 18.) Appellant applied for the writ and order involved in this appeal on December 27, 1961, more than half a year after Commissioner Hocke entered an order finding appellant extraditable. The first appeal was dismissed on April 26, 1961.

There is, of course, no guarantee that witnesses would appear for deposition under Rule 26, or would testify. In addition, it is noteworthy that most of the intended witnesses were not in prison, so Rule 26(a) would apply: "After commencement of the action, the deposition may be taken *without leave of court.* . . ." (Emphasis added). Consequently, appellant may not rely upon Rule 26, *Federal Rules of Civil Procedure.*

G. Appellant Had No Right to Letters Rogatory or a Commission.

Appellant quotes (without comment) Title 28, United States Code, Section 1781, involving letters rogatory and commissions. Appellant did not request letters rogatory. Furthermore, a showing that a commission is not adequate is a prerequisite to issuance of letters rogatory.

Gross v. Palmer, 105 Fed. 833.

No such showing was made.

H. There Was No Violation of Due Process of Law.

Appellant alleges a violation of due process of law and cites a number of cases in which the rights of criminal defendants have been expanded. However, the fact that these rights have been expanded is no argument for additional expansion.

It is manifestly incongruous for appellant, an alien, to claim a violation of due process in not being allowed to present evidence in a preliminary proceeding, when an American citizen has no right to present evidence before a Grand Jury, where preliminary proceedings in federal criminal cases are normally handled.

It is equally strange for appellant to claim a violation of due process in not being able to obtain evidence, when the committing magistrate *is not even required to examine defense evidence* (*Jimenez, supra,* 311 F. 2d 547, at 556).

VI.
CONCLUSION.

The order of the District Court should be affirmed for *each* of the following reasons:

1. This Court lacks jurisdiction to entertain the instant appeal.
2. The requested writ and order would not have had any effect upon witnesses not already willing to voluntarily testify.
3. An accused may not present depositions of foreign witnesses in extradition proceedings.
4. The requested depositions would involve unreasonable delays in the proceedings.
5. Wrongful exclusion of evidence in an extradition hearing, if such occurred, is not subject to judicial attack.
6. Appellant requested a useless writ or order, as the extradition proceedings had been completed.
7. There was no violation of due process of law.

It is respectfully submitted that the order of the District Court should be affirmed.

Respectfully submitted.

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Attorneys for Appellee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

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No. 18271

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAIME J. MERINO,

Appellant,

vs.

THEODORE HOCKE, UNITED STATES COMMISSIONER, etc., and the UNITED STATES OF AMERICA,

Appellees.

AMICUS CURIAE BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

CASES

STATUTES

No. 18271

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Appellees.

AMICUS CURIAE BRIEF.

I.

Statement of the Case.

The appellant's statement of the case as contained on pages 1 through 4 is not controverted.

II.

Appellant's Argument That the District Court Erred in Denying Appellant's Application in the Nature of a Writ of Mandamus Compelling the United States Commissioner to Permit Appellant to Take Depositions in the Republic of Mexico, or for an Order to Take Depositions Under the Appropriate Deposition Statutes of the United States Is Not Supported by Case Law or Statutes.

The following case law is cited in support of the argument that the above contention of appellant is without merit.

The attention of the Court is respectfully directed to the following recent case:

"Marcos Perez Jimenez vs. Manuel Aristeguieta, 311 F. 2d 547 (5th Cir. 12/12/62), certiorari denied. Habeas Corpus proceedings by former Venezuela Chief Executive on ground that his commitment to custody and detention as result of extradition proceedings was unlawful. Appeal from District Court judgment dismissing the petition for habeas corpus filed by appellant, Marcos Perez Jimenez.

Appellant contended denial of due process of law in District Judge's denial of request to take the deposition of a witness, pointing to 18 U.S.C. 3191."

Held:

1.— (page 556) "Section 3191 relates to the subpoenaing of witnesses and not to depositions." Supreme Court cited In Re Luis Oteiza y Cortes (136 U. S. 330) which held that the predecessor statute to Section 3191 "does not apply to documents or depositions offered on the part of the accused" and "that all the provisions of the law and statute contemplated the production of the defendant's witnesses in person before the magistrate for examination by him." It was held in a collateral discovery proceeding in this case that 18 U.S.C. 3190 permitting the use of properly authenticated *ex parte* depositions presented by the demanding country are not available to the defendant.

Aristeguieta v. Jiminez, 274 F. 2d 206, *cert. granted,* 345 U. S. 840;

First Nat. Bank of N. Y. v. Aristeguieta.

2.— "With respect to the evidence upon which the extradition magistrate acted, it must be remembered that the extradition merely determines probable cause making an inquiry like that of a committing magistrate and no more."

Benson v. McMahon, 127 U. S. 457, 463.

Probable cause was given its classic definition by Chief Justice Marshall when he held that he should not require evidence to convince himself that the defendant was guilty, but only that "furnishing good reason to believe that the crime alleged to have been committed by the person charged with having committed it".

III.

The Appellant Erroneously Cites 18 U. S. C. 3191 as Authority for the Right to Take Depositions by Way of a Subpoena in a Foreign Country.

This statute entitled "Witnesses For Indigent Fugitives": is clearly inapplicable to the instant case. The statute requires the following elements:

1. An affidavit to be filed by the person charged setting forth that there are witnesses whose evidence is material to his defense.

2. That he cannot safely go to trial without them.

3. What he expects to prove by each of them.

4. And that he is not possessed of sufficient means and is actually unable to pay the fees of such witnesses.

There is nothing in the record to indicate that the above elements are present in the case at bar. During the course of the extradition hearing the defendant produced several witnesses on his own behalf. These witnesses were brought from Mexico. The fugitive has employed many attorneys during the course of the proceedings and presented an expert witness and received the professional assistance of one of the ablest Mexican criminal lawyers who associated with his defense counsel. He is now at liberty on cash bail of $20,000.00.

It is respectfully submitted that the above facts and circumstances do not indicate that Section 3191 is applicable in this instance.

IV.

In View of the Denial of the Motion by the Circuit Court to Consolidate This Appeal With the Appeal From the Denial of the Petition for a Writ of Habeas Corpus, the Issue Before the Court at This Time Is Solely That of Matters Related to the Alleged Right of the Fugitive to Take Depositions in Mexico. It Is Contended That Appellant's Arguments Regarding Denial of Due Process of Law and Other Unrelated Matters Are Not the Proper Subject of This Appeal. No Answer to Appellant's Brief on These Extraneous Points Will Be Presented at This Time.

Appellant's brief seeks to bring before the Court matters such as discovery proceedings which have been liberalized by various Supreme Court decisions. Such

decisions, however, involved civil and criminal cases, and it is well-settled that extradition proceedings are not criminal in nature. It is contended that there is no analogy between discovery proceedings and the present issue. In discovery proceedings the defendant seeks access to matters in the possession of the prosecution. Such is not the case here. The evidence, if any, sought to be elicited by the fugitive, is not in the possession or control of the Government. The fugitive, as indicated before, produced witnesses who testified in his behalf.

V.

Conclusion.

In Conclusion, therefore, it is respectfully submitted that on the basis of the precedent set in 1890 by the Supreme Court, and affirmed through the years up to 1963 in the cases cited herein, the District Court did not err in denying appellant's request regarding depositions and its ruling should be affirmed.

NEWMAN & NEWMAN,
By PHILIP M. NEWMAN,
Amicus Curiae.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

PHILIP M. NEWMAN

No. 18,272

United States Court of Appeals

For the Ninth Circuit

GRACE TURNER,

Appellant,

vs.

THE MANHATTAN LIFE INSURANCE COMPANY, a New York Corporation,

Appellee.

APPELLEE THE MANHATTAN LIFE INSURANCE COMPANY'S ANSWERING BRIEF

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Subject Index

VII

VIII

IX

X

Table of Authorities Cited

Cases

Codes

No. 18,272

United States Court of Appeals
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GRACE TURNER,
Appellant,

vs.

THE MANHATTAN LIFE INSURANCE COMPANY,
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Appellee.

APPELLEE THE MANHATTAN LIFE INSURANCE COMPANY'S ANSWERING BRIEF

Appellee does not adopt Appellant's statement of the case, believing a more complete summary is contained in the trial court's memorandum opinion in support of its judgment for the defendant insurer, The Manhattan Life Insurance Company.

STATEMENT OF THE CASE

This action arises out of an insurance policy issued by Manhattan on the life of Nobel Andre, the insured. The policy, dated February 7, 1959, became effective

March 20, 1959, when it was delivered by Manhattan to Andre and the first premium paid. (Part 1 Application, exhibit to LaPointe deposition.) At that time it was assigned to the Wells Fargo Bank, appellant's predecessor in interest, as loan collateral by Andre Paper Box Company, the policy owner and beneficiary. (Assignment of policy, exhibit to LaPointe deposition.) Less than a year later the insured died as a result of severe coronary arteriosclerosis with myocardial fibrosis. (Coroner's death certificate, Coroner's report.)

The Wells Fargo Bank claimed the face amount of the policy. An investigation was made by Manhattan. As a result, the claim was rejected and the contract of insurance rescinded. The bank refused to accept a return of the premiums paid on the policy; and suit was brought by its assignee, Grace Turner, for the policy's face amount. (Correspondence, exhibit to LaPointe deposition.)

The insurer rescinded its policy and disclaimed death benefit liability on the ground that Part 2 of the insured's application, dated January 20, 1959, forming part of the policy, contained material misrepresentations going to the very heart of the medical risk it was asked to insure against. Specifically, the insurer contended the negative answers to the following questions contained in the insured's medical history (Part 2 of the Application) were untrue, were known by the insured to be untrue, and were material to the risk the insured by his application asked the insurer to assume. (Answer of The Manhattan Life Insurance Company, C.T. p. 88, lines 22-25.)

Q. [19] Have you ever been an inmate of, or received treatment or cure at an . . . hospital . . .?
A. No.

Untrue answers were also given to each of these questions:

[16] Have you ever suffered from any ailment or disease of: (a) The Brain . . .? (b) . . . Blood Vessels . . .?

The trial court found Manhattan's contentions to be correct and the insured's answers to have been untrue.

In particular, Judge Zirpoli found that on October 22, 1958, three months before the insured applied for insurance, he had been hospitalized for three days in the Hahnemann Hospital, San Francisco, as a result of a cerebral vascular accident (Finding 6, C.T. 60), and that less than a year before that, in December 1957, he had experienced a ten-day episode of chest pains which his doctor advised him constituted *angina pectoris* and resulted from coronary insufficiency. (Finding 7, C.T. 60.) Neither finding is challenged.

The trial court further specifically found the answers to the questions were false, were known by Andre at the time given to be false (Finding 5, C.T. 60), were not the result of inadvertence or misunderstanding of the questions asked (Finding 8, C.T. 60), were material misrepresentations to the insurer of the state of the insured's physical condition (Findings 9 and 10) and were relied on by the insurer in issuing

its policy. As a result, the court concluded the insurer had a right to and did rescind its policy on Andre's life.

SUMMARY OF ARGUMENT

I

There is substantial evidence in the record that Andre's answers to Questions 19, 16(a) and 16(b) in his application to the Manhattan Life Insurance Company were untrue when he gave them, were untrue when the policy issued on such application took effect, and were known by him at both times to be untrue.

II

There is substantial evidence in the the record to support the trial court's finding that the insured's answers to Questions 19, 16(a) and 16(b) were made in bad faith.

III

There is substantial evidence in the record Manhattan relied on the representations Andre made about his health.

IV

The action taken by Pacific Mutual is irrelevant.

V

There is nothing in the record requiring Manhattan to have disbelieved Andre.

VI

Dr. Robbins' opinion that Manhattan properly relied on Andre's representations is soundly based on evidence in the record.

VII

The medical histories given by Andre to Dr. Holliger, the Hahnemann Hospital and the Presbyterian Hospital for the purpose and at the time of treatment are admissible in evidence.

VIII

Dr. LaPointe's testimony Manhattan would not have accepted the medical risk presented by Andre had it known the truth is admissible in evidence.

IX

Wills v. Policy Holders Life Ins. Ass'n, 12 C.A. 2d 659 is readily distinguishable.

X

As a matter of law Manhattan was entitled to rescind its policy.

ARGUMENT

I

THERE IS SUBSTANTIAL EVIDENCE IN THE RECORD THAT ANDRE'S ANSWERS TO QUESTIONS 19, 16(a) and 16(b) IN HIS APPLICATION TO THE MANHATTAN LIFE INSURANCE COMPANY WERE UNTRUE WHEN HE GAVE THEM, WERE UNTRUE WHEN THE POLICY ISSUED ON SUCH APPLICATION TOOK EFFECT, AND WERE KNOWN BY HIM AT BOTH TIMES TO BE UNTRUE.

The representations in issue, made in the form of negative answers to the questions asked in the insured's application to Manhattan for insurance, were made on January 20, 1959, and continued until March 20, 1959, when the policy, of which the application formed a part, took effect. (Part 2 application, Questions 16(a) and (b), 19, exhibit to deposition of L. Gordon LaPointe, M.D.) *Insurance Code* § 356; *Security Life Ins. Co. v. Booms,* 31 Cal. App. 119; *General Accident, F. & L. A. Corp. v. Industrial Accident Comm'n,* 196 Cal. 179. What was represented, however, was not true. For on October 22, 1958, three months before he signed the application, Andre had been hospitalized for three days at the Hahnemann Hospital in San Francisco as the result of a stroke. (Hahnemann Hospital Admission Records, exhibit to deposition of Mary Moran.)

The hospital records show he gave a history at the time of admission of being stricken with dizziness, difficulty in talking and expressing his thoughts, and with numbness in his right hand. (Admission Records, Hahnemann Hospital pp. 1-2.) He gave the same history to his doctor (Holliger) who, making a contem-

poraneous entry in his own journal on October 22, diagnosed the occurrence as a cerebral vascular accident or, in layman's language, a "stroke". (Holliger deposition, p. 30, line 23; Journal p. 21, deposition of Dr. Victor H. Holliger.) No other diagnosis was given nor was the patient treated for anything else while at the hospital. (Admission Records, Hahnemann Hospital.)

It is known the effects of the stroke lasted at least eight days, for in Dr. Holliger's journal under the date October 31, 1958, the following entry appears: "Effects from C.V.A. are daily improving, able to focus better and read now." (Journal p. 22.) Evidently, Andre still had some trouble focusing his eyes at the time. (Holliger Dep. p. 35, line 10.)

According to Dr. Holliger the cerebral vascular accident was the result of a thrombosis or rupture of a blood vessel in the brain. (Holliger Dep. p. 30, line 25 to p. 31, line 5.) He was certain he told Andre about it, who, to the best of the doctor's ability, was kept advised of the condition of his health. (Holliger Dep. p. 34, lines 6-15.)

Evidently Andre remembered what he had been told. Five months later on March 26, 1959, six days after Manhattan's insurance policy took effect, Andre was admitted to the Presbyterian Hospital in New York City. At the time he gave a history of having experienced four months previously a transient right hemiparesis accompanied by an inability to speak which had been diagnosed as a stroke and for which he had

been hospitalized. (Presbyterian Hospital Records, pp. 7-8, exhibit to deposition of Francis K. Tuxbury.)

Faced with the obvious impact of this record on the issue of knowing misrepresentation, appellant attempts to excuse away the false answers regarding the insured's hospitalization by arguing, first, the question asked in the application was so ambiguous as not to have been asked and, second, the hospitalization was a minor matter which Andre forgot about.

Words may be slippery things but the disjunctive question, "Have you ever been an inmate of, or received treatment or cure at an asylum, hospital or sanitarium?" is about as plain as language admits. Nor can the obvious false answer to the question asked be brushed off as a casual inadvertence. The insured was clever enough to realize notice of hospitalization would probably lead to an examination of the hospital record with its tell-tale diagnosis of "C.V.A." and to no insurance at *any* rate. After all, Andre was aware that even without any record of hospitalization or stroke he had been turned down by Canada Life and rated by Pacific Mutual.

Appellant next suggests the insured forgot about the stroke, as he might, perhaps, a common cold. But Dr. Holliger's record made at the time of the events does not bear this out.

The doctor in his journal entry of October 22, 1958, states: "Sudden onset, speech difficulty and incoordination today. Small C.V.A. Sent to hospital." On October 28: "Discharged from hospital . . . doing o.k.

now. No lack of coordination, speech difficulty. Reflex o.k." Again from his journal, on October 31, 1958, eight days after the onset of the stroke the doctor states: "Effects from C.V.A. are daily improving, able to focus better and read now." When asked about this entry on deposition the doctor admitted that eight days after the stroke the patient still had difficulty focusing [his eyes]. (Holliger Dep., pp. 33-34.)

Andre knew about his condition. Anyone, but a fool, hospitalized under the circumstances he was and who two days later still had difficulty putting his thoughts in words and eight days later focusing his eyes would. (Presbyterian Hospital Records p. 7.) So much for the cerebral circulatory system.

To turn now to the coronary circulatory system. There is substantial evidence in the record Andre knowingly misrepresented the condition of this system too. The chest pains suffered by Andre in December 1957 but denied in his application, were diagnosed at the time by Dr. Holliger as involving Andre's coronary circulatory system.

The written record speaks for itself. On December 26, 1957, according to Dr. Holliger's journal entry made at the time (Journal p. 20, Holliger Dep. p. 24), Andre gave him a detailed history of chest pains which had begun ten days earlier after he had been to a football game. A physical examination was given, an elevated sedimentation rate noted and an EKG taken the following day. (Exhibit p. 2, Holliger Dep.) Three days later, December 30, 1957,

Andre came into Holliger's office for a "talk" (Holliger Dep. p. 25, line 17; Journal p. 21) at which time he was told Holliger's diagnosis: "Angina and coronary insufficiency". (Holliger Dep. p. 26, line 15.) Moreover, Holliger went over the diagnosis with Andre in detail telling him the chest pains were heart pains and that he had coronary insufficiency. (Holliger Dep. p. 26, line 13 to p. 28, line 18.) To the date of his deposition (August 11, 1961) Dr. Holliger had no reason to believe his diagnosis of *angina pectoris* and coronary insufficiency made at the time was incorrect. (Holliger Dep. p. 29, line 9 to line 17).

These pains apparently continued to reoccur during 1958. (Presbyterian Hospital Records, p. 7.)

II

THERE IS SUBSTANTIAL EVIDENCE IN THE RECORD TO SUPPORT THE TRIAL COURT'S FINDING THAT THE INSURED'S ANSWERS TO QUESTIONS 19, 16(a) and 16(b) WERE MADE IN BAD FAITH.

The trial court found the answers to Questions 19, 16(a) and 16(b) of the application were false, were known by Andre to be false, did not result from misunderstanding or inadvertence, and constituted material misrepresentations of the insured's physical condition.

Appellant does not challenge the findings that the insured answered the questions negatively (Finding 4), that the facts were otherwise than represented by the insured (Findings 6 and 7), and that the false an-

swers given constituted a material misrepresentation to Manhattan of the insured's physical condition. (Findings 9 and 10.) Surely no other reasonable inference could be drawn by the trial court from this record than that Andre knowingly made such answers in bad faith. (C.T. p. 53, lines 3-20.)

III

THERE IS SUBSTANTIAL EVIDENCE IN THE RECORD MANHATTAN RELIED ON THE REPRESENTATIONS ANDRE MADE ABOUT HIS HEALTH.

Dr. LaPointe, Manhattan's medical director, was the person charged with making the final decision whether or not insurance would issue. (LaPointe Dep. pp. 4-5.) He testified on deposition that had he known of the information contained in the Hahnemann Hospital records Manhattan would not have insured Andre's life. (LaPointe Dep. pp. 13-14, line 3.)

Obviously knowledge of this episode involving the cerebral circulatory system was medically important and Andre's misrepresentation concealing it material. *Insurance Code* §§360 and 334. *Cohen v. Penn Mutual Life Ins. Co.,* 48 C.2d 720 (1957); *National Life & Accident Ins. Co. v. Gorey,* 249 F.2d 388 (9th Cir. 1957). Its medical materiality was confirmed by appellee's expert, Dr. Robbins. (R.T. p. 88, line 22 to p. 89, line 24.) It could only have negatively affected Manhattan's evaluation of the medical risk. (LaPointe Dep. p. 12, line 1 to p. 14, line 3.)

Moreover, Manhattan had no information indicating Andre had angina or chest pains. (LaPointe Dep. p. 8, line 22 to p. 9, line 5.)

On March 20, 1958, in connection with a preliminary inquiry to Manhattan for insurance Andre authorized Holliger, his personal physician since 1949, to supply Manhattan ". . . with any and all information you have regarding my medical history and physical condition, up to and including *this* date." (Photocopy attached to Holliger's copy of his March 31, 1958, letter to Manhattan, exhibit Dr. Holliger's deposition.) Pursuant to this authorization LaPointe wrote Holliger March 25, 1958, requesting information "re care rendered", to which Holliger replied on March 31, 1958, "The above named person was under observation by me from 11/27/50 to 12/26/57." Note that the period of observation was *to* but not *through* December 26, 1957, the day Andre reported the chest pains Holliger diagnosed as angina. Nothing was said to Manhattan about this.

LaPointe next wrote Dr. Holliger on January 29, 1959, asking him to "comment re check-ups including any data *since* your report to us of March 25, 1958". To this Holliger replied on February 16, 1959: "I have very little to add to the information that you already have regarding Mr. Andre." A ten-day attack of chest pains diagnosed as angina and coronary insufficiency and a subsequent stroke apparently constituted *very little,* at least for insurance purposes.

The chest pains were important. The three doctors, LaPointe, Robbins, and Holliger each testified to the

significance of Andre's chest pains in evaluating the medical risk presented by him. This bit of medical history was the key to the correct interpretation of the electrocardiograms submitted to Manhattan. (LaPointe Dep. p. 9, line 14 to p. 11, line 3; Dr. Robbins' interrogation by the trial court, R.T. 93, line 9 to p. 94, line 5; R.T. 84, line 20 to p. 86, line 21.) Appellant's witness, Dr. Holliger, stated, "It is our policy that you combine your laboratory, your history, your physical findings; all three have to go together." (Holliger Dep. p. 52, lines 13-15.)

The question before the insurer was not whether Andre had a heart condition. As Dr. LaPointe quite freely admits, he knew he had. The question before the insurer was whether, despite the heart condition it knew about, Andre was still an insurable but rated risk.

In the spring of 1958 on the basis of the 1956 history given in an application to Pacific Mutual and the December 1957 EKG, the only EKG sent Manhattan at the time by Dr. Holliger, Manhattan felt he wasn't.

In January 1959 the question of insurance was in effect again raised by Andre and a new application (medical history) and a current EKG sent Manhattan. On the basis of the current application and a supporting EKG, both of which indicated an asymptomatic condition (R.T. 85, line 11 through 86, line 21), LaPointe judged Andre a rated but insurable risk. LaPointe Dep. pp. 14, 15.)

In short, Manhattan's medical examiner said he relied on the insured's negative answers to the questions in evaluating the medical risk presented by the insured. The trial court was entitled to believe he did, particularly when the two other doctors testifying said it was sound to do so.

This section of appellee's argument, can best be concluded by the forceful illustration of interpolating the record at bar within the language of this court in *National Life and Accident Insurance Co. v. Gorey,* supra, p. 395: "The misstatement[s], according to the only evidence on the subject, [were] relied upon by the defendant, and did materially affect the defendant's willingness to accept the risk. The defendant asked for specific answers to [three] certain questions; the answers given were not true, and defendant was denied the right to determine for itself the matter of the deceased's insurability, and the underwriting risks it was willing to undertake."

IV

THE ACTION TAKEN BY PACIFIC MUTUAL IS IRRELEVANT.

What Pacific Mutual may or may not have done about insuring Andre is irrelevant. It is true Manhattan knew Andre had applied to Pacific Mutual for additional coverage in 1959. It is also true appellant's witness, Crooks, a local insurance broker with offices with Pacific Mutual, testified he told Manhattan's San Francisco representative that Pacific Mutual had de-

clined such additional coverage. But Crooks didn't say *when* he told Manhattan's local agent and Dr. Murray, Manhattan's assistant medical director stated, in answer to appellant's interrogatories, that to the best of his knowledge and belief Manhattan had no knowledge prior to the insured's death that Pacific Mutual declined coverage. (C.T. pp. 27, 30.)

But what is the relevance of what Pacific Mutual did? There is no evidence of what Pacific Mutual knew about Andre or why it declined. It already had a $25,000 rated policy on Andre as it was. Most probably it decided that $25,000 in a rated class was enough. That was all Manhattan would take.

V

THERE IS NOTHING IN THE RECORD REQUIRING MANHATTAN TO HAVE DISBELIEVED ANDRE.

Despite appellant's suggestions, there is nothing in the record requiring Manhattan to have adopted the hypothesis the insured was a liar. In addition to the application comprising a medical history, examination and heart chart, defendant had a current EKG, a chest x-ray, a copy of a 1957 EKG, the records of the MIB, and all other documents attached to Dr. LaPointe's deposition, including Dr. Holliger's letter conveniently omitting any reference to the 1957 angina and the 1958 hospitalization and stroke. This information all pointed towards an arrested, stabilized asymptomatic heart condition, that is, to an insurable but rated risk.

Weir v. New York Life Ins. Co., 91 Cal. App. 222, has no applicability. There the insurer knew the insured was lying about the very representation in issue. And neither has *Di Pasqua v. California etc. Life Insurance Company,* 106 C.A.2d 281. There the information regarding hospitalization, about which a misrepresentation was made in the application, was in the insurer's file. No comparable information was in Manhattan's files at any time. Finally, a waiver as to lack of knowledge as to the chest pains, if one were found, is not a waiver as to the misrepresentation regarding hospitalization. *S. F. Lathing Co. v. Penn Mutual L. Ins. Co.,* 144 C.A.2d 181.

VI

DR. ROBBINS' OPINION THAT MANHATTAN PROPERLY RELIED ON ANDRE'S REPRESENTATIONS IS SOUNDLY BASED ON EVIDENCE IN THE RECORD.

Appellant states that Dr. Robbins' opinion is invalid because ". . . it is predicated upon a false hypothesis" in that ". . . there is absolutely no evidence of any recurring [chest] pains during 1958." Appellant is mistaken. Andre in his medical history given the Presbyterian Hospital on March 26, 1959, told the admitting physician that for the past year he experienced bilateral dull chest pains unrelated to exercise and usually occurring in late afternoon and subsiding in fifteen minutes with rest. (Presbyterian Hospital Records, p. 7.)

VII

THE MEDICAL HISTORIES GIVEN BY ANDRE TO DR. HOLLINGER, THE HAHNEMANN HOSPITAL AND THE PRESBYTERIAN HOSPITAL FOR THE PURPOSE AND AT THE TIME OF TREATMENT ARE ADMISSIBLE IN EVIDENCE.

Appellant urges the medical history given by Andre at the various times he sought medical treatment is inadmissible hearsay.

This objection, touching as it does a fundamental doctrine of the law of evidence, reflects a misconception of what the issues of this case are about. The history given by Andre at the time of his admission to the Hahnemann and Presbyterian hospitals, including the diagnosis (offered but excluded by the trial court), was offered not primarily to prove the truth of the matter asserted. Manhattan had no interest in challenging the diagnosis or contesting the truth of the histories given the various hospitals and doctors. The statements and excluded diagnosis were offered as *the* operative facts, verbal acts so to speak: to show *what* the records stated, not the *truth* of what they stated. As such they are not hearsay.

Even so, appellee need not limit its offer of proof to the statements as operative facts. The hospital records are admissible under 28 USC 1732 as records kept in the ordinary course of business and the history they contain, given by Andre to secure treatment, is admissible to prove the truth of the matter asserted under a recognized exception to the hearsay rule.

The Federal rule is stated in *Lutz v. New England M. L. Ins. Co.,* 161 F.2d 833 (9th Cir. 1946); *Meaney*

v. United States, 112 F.2d 538 (2d Cir. 1940) (L. Hand, J.); *Stewart v. Baltimore & O.R. Co.,* 137 F.2d 527 (2d Cir. 1943) (A. N. Hand, J.); and *Medina v. Erickson,* 226 F.2d 475 (9th Cir. 1955), expressly disavowing *New York Life Ins. Co. v. Taylor,* 147 F.2d 297 (D. C. Cir. 1945).

These cases sensibly point out that when medical history is given to the treating physician by the patient at the time of treatment for the purpose of treatment, a sufficient safeguard of veracity exists to permit an exception to the hearsay rule.

VIII

DR. LA POINTE'S TESTIMONY MANHATTAN WOULD NOT HAVE ASSUMED THE MEDICAL RISK PRESENTED BY ANDRE HAD IT KNOWN THE TRUTH IS ADMISSIBLE IN EVIDENCE.

Manhattan introduced the entire deposition of Dr. LaPointe and certain of the attached exhibits. Appellant introduced the balance so all the exhibits are in evidence. Lines 6 through 12 on page 9 of the deposition were objected to and stricken from the record by agreement. Admission of the testimony beginning on line 13 of page 9 through line 4 on page 11 and beginning on line 5 of page 12 through line 3 of page 14 and beginning on line 21 of page 14 through line 3 of page 15 is objected to on the grounds it constitutes a self-serving statement by the insurer that the application would not have been accepted had the truth of the matter misrepresented been known.

The exclusionary rule urged by appellant is outmoded. The modern trend of authority is that while the trier is the sole judge of the critical issue to be decided, it is no objection to expert testimony that it is given on the critical issue. *Eastern Trans. Line v. Hope,* 95 U.S. 297, 298, 24 L.Ed. 477, 478; *Millers' Nat. Ins. Co. v. Wichita Flour M. Co.,* 257 F.2d 93 (10th Cir. 1958); *Wells Truckways, Ltd. v. Cebrian,* 122 C.A.2d 666 (1954); *People v. Cole,* 47 C.2d 99 (1956). As recently as February 1, 1963, the California court in *People v. Peoples,* 212 ACA 603, 605, said: "Although there is a conflict between the various jurisdictions of this country on the question (see 66 A.L.R 2d 1048), this state is committed to the rule which, in a proper case, permits testimony expressing an opinion on the ultimate fact."

The case at bar is just such a proper case. The statutory definition of materiality requires inquiry into the ". . . reasonable influence of the facts upon the *party* to whom the communication is due, in forming *his* estimate of the disadvantages of the proposed contract, or in making his inquiries", Insurance Code § 334. (Italics added.) A more subjective test is hard to imagine.

IX

WILLS v. POLICY HOLDERS LIFE INS. ASSN., 12 C.A.2d 659 IS READILY DISTINGUISHABLE.

Wills involved a suit on a life insurance policy by the beneficiary of the insured who had died from "sclerosis with occlusion of the left coronary artery of the heart." On her application the insured had stated ". . . I am in good health and so far as I know have no disease . . ." An autopsy disclosed that apparently at the time she made the statement she was suffering from heart disease; however, ". . . there was not a syllable of evidence to indicate that the insured possessed knowledge of that fact." The appellate court reversed the trial court and held the insurer had no right to void the policy since there had been no showing the insured knew the statements regarding her health were false or had reasonable cause to believe they were false.

Obviously such is not the situation here.

X

AS A MATTER OF LAW MANHATTAN WAS ENTITLED TO RESCIND ITS POLICY.

When false representations as to material matters have been made, the existence of a fraudulent intent to deceive is not essential. *Telford v. New York Life Ins. Co.*, 9 C.2d 103, 105. The representations in the form of answers to specific questions asked Andre about his medical history were material as a matter

of law and, since false, vitiated the contract. *Cohen v. Penn Mutual Life Ins. Co.,* 48 C.2d 720; *National Life and Accident Insurance Co. v. Gorey,* 249 F.2d 388, 393, and cases cited.

CONCLUSION

There is more than substantial evidence in the record that the representations in issue, contained in the application and forming a part of the policy, were false, were material in fact, are deemed material by law, and were relied on by Manhattan in issuing its policy. Appellee, therefore, can end only where it began: As a matter of law Manhattan was entitled to have a true picture of the insured's apparent medical condition at the time it was asked to assume the risk of underwriting his life expectancy. *Cohen v. Penn Mutual Life Ins. Co.,* supra; *National Life and Accident Ins. Co. v. Gorey,* supra. The evidence shows such a picture was not given. Significant material facts pertaining to appellant's medical history and bearing on the state of his health were withheld. For this reason the trial court's judgment that appellee could and did rescind its contract of insurance should be affirmed.

Dated, San Francisco, California,
April 15, 1963.

JAMES F. THACHER,
THACHER, JONES, CASEY & BALL,
Attorneys for Appellee.

Certification

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

James F. Thacher,
Attorney for Appellee.

No. 18,272

United States Court of Appeals

For the Ninth Circuit

GRACE TURNER,
Appellant,

vs.

THE MANHATTAN LIFE INSURANCE COMPANY, a New York Corporation,
Appellee.

Appeal from the United States District Court for the Northern District of California, Southern Division

OPENING BRIEF OF APPELLANT

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Subject Index

Table of Authorities Cited

Cases Pages

Statutes

Texts

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I

PLEADINGS AND FACTS DISCLOSING THE BASIS OF JURISDICTION OF THE DISTRICT COURT AND THE JURISDICTION OF THE COURT OF APPEALS TO REVIEW THE JUDGMENT IN QUESTION

(1) Statutory Provisions Sustaining Jurisdiction.

(a) Jurisdiction of District Court.

The action is a suit by a California resident to recover from a New York Corporation proceeds of a life insurance policy in an amount of twenty-five thousand dollars ($25,000).

Title 28 U.S.C. 1332. Diversity of citizenship; amount in controversy:

> "(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and is between—
>
> (1) citizens of different states;"

(b) Jurisdiction of Court of Appeals.

Judgment was entered by the District Court in favor of the Defendant and against the Plaintiff. Judgment was entered July 10, 1962. Notice of appeal was filed by Plaintiff August 9, 1962.

The judgment being final and timely notice of appeal having been given this Honorable Court has jurisdiction to review the judgment under the provisions of 28 U.S.C. 1291-1293.

(2) The Complaint.

The complaint alleges the corporate existence of the defendant pursuant to the laws of the State of New York (Transcript of Record, p. 11), and the amount in controversy to be the sum of $25,000. (Transcript of Record pp. 12, 13.) The complaint was filed in the Superior Court of the State of California and was removed to the United States District Court pursuant to Petition for Removal filed by defendant (Transcript of Record p. 6) setting forth the California citizenship of plaintiff. (Transcript of Record p. 7.)

II

STATEMENT OF CASE, QUESTIONS INVOLVED AND MANNER RAISED

The action below was instituted to collect the proceeds of a policy of life insurance following the death of the insured. The defense of misrepresentation of the physical condition of the insured at the time of application for insurance was interposed by the answer. The judgment in favor of the defendant as predicated upon the findings determined that the defendant was entitled to rescind the contract of insurance by reason of misrepresentations of the insured. The basic questions involved in the appeal are the sufficiency of the findings as to misrepresentation, falsity, knowledge of falsity, reliance, the right of the insured to rely upon the representations, the diligence of the insurer, the admission of incompetent evidence and the failure of the Court to give due weight to basic presumptions of law. The questions are raised by a direct appeal from the judgment of the District Court.

III

SPECIFICATION OF ERRORS

(1) The evidence does not support the findings that the answer of the decedent to each of the following questions was false and was known by Andre at the time it was given to be false:

No. 19—whether he had ever been hospitalized;

No. 16(a)—whether he had ever suffered from any ailment or disease of the brain;

No. 16(b)—whether he had suffered from any ailment or disease of the blood vessels. (Finding 5.)

(2) The evidence when weighed with the applicable presumptions of law does not support the finding that false answers to each of the questions referred to were knowingly made in bad faith by the insured. (Finding 8.)

(3) The evidence does not support the finding that the defendant relied upon the representations of the insured in the issuance of the policy. (Finding 11.)

(4) The evidence does not support the finding that the defendant would not have issued the policy on Andre's life had it been aware of the true facts concerning his physical condition. (Finding 11.)

(5) The District Court erred in concluding that the defendant did not waive its right to know the facts and did not neglect to make inquiry as to the truth of representations. (Conclusion of Law 3.)

(6) The District Court erred in admitting into evidence against a beneficiary of an insurance policy with a vested interest, declarations of the decedent not made at the time of the procuring of the policy, and not part of the res gestae (Reporter's Transcript, p. 16, l. 9; p. 22, l. 12; p. 23, l. 3; p. 23, l. 12; p. 28, l. 21 to p. 30, l. 2; p. 31, l. 24 to p. 32, l. 11; Order of Court on Objections, Tr. p. 49-50.)

(7) The District Court erred in admitting into evidence the testimony of the Medical Officer of defendant who had evaluated the risk, that the defend-

ant would not have assumed the risk had different answers been given in the application of the insured. (La Pointe Deposition—Rep. Tr. p. 48, l. 21 to p. 51, l. 19; Order of Court on Objections, Tr. pp. 49-50.)

(8) The District Court erred in admitting into evidence the records of the Presbyterian Hospital relating to an illness occurring subsequent to the issuance of the policy. (Rep. Tr. p. 19, l. 1 to l. 21; Order of Court on Objections, Tr. pp. 49-50.)

(9) The District Court erred in giving to the representations made in the application for insurance the weight of warranties, contrary to the express provisions of the policy. (Exhibits A and B for Defendant.)

(10) The District Court erred in concluding that the Defendant was entitled to rescind the policy.

IV

ARGUMENT

STATEMENT OF FACTS

On January 20, 1959, Noble Andre made application to The Manhattan Life Insurance Company for a policy insuring his life in a requested amount of fifty thousand dollars ($50,000). The applicant was not unknown to the defendant. In March of 1958 a trial application had been submitted to Manhattan to test the insurability of Andre. (Rep. Tr. pp. 65-66.) To such trial application was attached a report of a physical examination of Andre made on behalf of

Pacific Mutual Life Insurance Company by Doctor David Leigh Rodgers on July 27, 1956. A portion of the application made to Pacific Mutual in 1956 was also attached to the trial application submitted to Manhattan in 1958. (Rep. Tr. p. 66.) The material so supplied to Manhattan in 1958 revealed that the applicant had been "rated" by Pacific Mutual in 1956, had been declined by another insurer because of EKG findings and had EKG tracings suggestive of past myocardial damage. (Exhibits La Pointe deposition.) There was further submitted with the 1958 application an electrocardiograph taken December 26, 1957. (Rep. Tr. p. 68, Exhibit La Pointe Deposition.)

The 1958 application to Manhattan related to the proposed issuance of a policy in the amount of $100,000. Review of the application by L. Gordon La Pointe M.D., Medical Director of Manhattan, resulted in a qualified commitment for only one-fifth of the amount of insurance applied for and that at a Class F rating. The observation of the Medical Director was that "the applicant's status is worse than in August 1956." (Rep. Tr. p. 68.) The 1958 commitment for the reduced amount at a rated classification was not acceptable to Andre.

By reason of the state of the record and knowledge already in its possession the defendant, upon receipt of the application of January 1959, subjected Andre to special examinations including x-rays and electrocardiograms not normally undertaken in an application of the nature of that being processed. (Rep. Tr. p. 75.) Andre was examined by Doctor David Leigh

Rodgers, the same physician who had conducted the 1956 examination on behalf of Pacific Mutual and whose findings had been the cause of a "rated" classification.

The 1959 examination by Dr. Rodgers was made conjointly for the benefits of both Manhattan and Pacific Mutual by reason of simultaneous applications filed with the two companies by Frank Crooks, the agent who was eneadvoring to sell insurance to Andre. (Rep. Tr. p. 72.) Manhattan was aware of the concurrent Pacific Mutual application and made a notation in its records to watch the outcome of the Pacific Mutual action upon such application. (Rep. Tr. pp. 73-74.) Pacific Mutual declined coverage and Manhattan was so advised. (Rep. Tr. p. 74.)

The 1959 application to Manhattan disclosed that the applicant had been "rated" by Pacific Mutual in 1956 and had been declined by Canada Life in 1956. The application also named Dr. Holliger as a physician by whom Andre had been treated within a period of five years and revealed that an electrocardiogram had been taken by such physician. (Exhibit B in evidence.) Written authorization was given to Manhattan by Andre affording access to his medical records and to information respecting his physical condition. (Exhibits La Pointe deposition.) Correspondence was had between Manhattan and Doctor Holliger. (Exhibits to La Pointe deposition and to Holliger deposition.)

Manhattan was a member of the Medical Information Bureau, a clearinghouse of medical information

on insurance applicants. Upon review of the x-ray and electrocardiogram Manhattan reported to the M.I.B. that the x-ray showed an amount of enlargement and that the electrocardiogram disclosed an unusual T wave and a peculiarity of the S-T interval. (Plaintiff's Exhibit last in order.)

Upon consideration of the application Manhattan decided to issue only one-half of the amount of insurance requested and to charge an extra annual premium of $375 for three years in addition to a special class rating. A policy in the face amount of $25,0000 issued upon such basis bearing date of February 7, 1959, and was delivered March 20, 1959. A premium of $1819.00 was paid for the first year and a like premium was paid March 3, 1960. (Pre-trial Order.) The limitation of the amount of insurance, the increased premiums and the special class rating were predicated upon the physical condition and history of Andre. (Letter La Pointe March 3, 1959, Exhibit to La Pointe deposition.)

The policy designated Andre Paper Box Company, a corporation, as beneficiary. The premiums were paid by, and all rights of ownership resided in, Andre Paper Box Company.

Noble Andre died March 18, 1960. Due proof of loss was submitted to the defendant. (Answer paragraph I.) The insurer gave notice of rescission of the policy by letter dated June 20, 1960 "because of misrepresentations material to the risk made by Noble Andre in his application." The claimed misrepresentations may be generally classified as a concealment of a hos-

pitalization for a period of 48 hours for observation for a possible cardio-vascular accident and misrepresentations relating to the condition of the heart.

The District Court found grounds for rescission.

(1) The Evidence Does Not Support the Findings That the Answers of the Decedent to the Questions Relating to Hospitalization, Brain and Blood Vessels, Were False and Were Known to Be False.

The composite finding numbered 5, relates to three questions appearing in the written application signed by Noble Andre on January 20, 1959. The District Court found that the answer to each question was false and was known by Andre at the time given to be false. The finding that Andre had given an answer false, and known at the time to be false, to the question "whether he had ever been hospitalized" is predicated upon a negative answer to question 19. The basis for the finding was an episode occurring October 22, 1958 wherein a sudden dizziness and speech difficulty prompted Doctor Holliger to place Andre in Hahnemann Hospital in San Francisco for observation from 3:05 P.M. on such day to 3:44 P.M. on October 24, 1958. The stay was uneventful. On October 23 Andre went to Children's Hospital where an electroencephalogram was taken with negative results. On October 24 Andre was "ambulatory as desired." He was "dismissed walking." (Deposition and exhibits, Mary Moran.) The episode was hardly one which would make an indelible impression nor one which an applicant would be tempted to conceal. The tests were negative and Doctor Holliger's subsequent

appraisal was "it might be my impression he may have a vasospastic—in other words, spasm of the blood vessel rather than actual injury to the blood vessel itself." (Holliger Deposition, p. 51, ll. 21-23.) The doctor apparently did not consider the matter of sufficient importance to give it mention in his letter to the insurance company concerning Andre's physical condition. (Holliger Deposition, p. 51, l. 24.)

Apart from the absence of necessity for an applicant to conceal such fact, the impossibility of doing so must have been apparent to a man of Andre's intelligence. The hospital record was available; the incident was recited in the records of Doctor Holliger; and Andre had given written authorization to Manhattan to examine his records and consult his doctor. The records of his medical insurance carrier were also available revealing his claim for hospitalization benefits. Why then was a negative answer given to question 19? A reading of the question will supply the reason. The question is so ambiguous that it cannot be ascertained therefrom that the inquiry relates to the mere status of being a patient in a hospital. Question 19 reads:

> "19. Have you ever been an inmate of, or received treatment or cure at an asylum, hospital, or sanitarium?"

Appellant contends that the question is so misleading that it does not suggest the circumstance of admission to a hospital. The words "inmate", "cure", "asylum" and "sanitarium" connote a mental disorder or some abnormality. The reference to "hospital"

is masked and obscured by the remainder of the question. It certainly is not tantamount to an inquiry as to whether the applicant had ever been hospitalized. The ambiguity is of the making of the defendant and in accordance with the well settled policy of law the uncertainty and ambiguity is to be interpreted most strongly against the insurer. (California Civil Code 1654; *Witherow v. United American Ins. Co.,* 101 C.A. 334; *Everett v. Standard Accident Insurance Co.,* 45 C.A. 332.) The ambiguity here found is much more gross than that encountered in *Newton v. S.W. Mutual Life Assn.,* 116 Iowa 311, 90 NW 73, wherein the question "Has any company ever declined to grant insurance on your life?" was held to be too vague to require an applicant to state that he had been declined by the Woodmen of the World. The Court in the *Newton* case admonishes us:

> "If any construction can reasonably be put on the question and the answer such as will avoid a forfeiture of the policy on the ground of falsity of the answer, that construction will be given, and the policy will be sustained."

The negative answer to the question whether he had ever suffered from any ailment or disease of the brain was found objectionable by the Court below.

In the light of the requirement of the application that the answers be true "to the best knowledge and belief" of the applicant it is difficult to condemn such answer as "false" and "known to be false". The dizziness and temporary speech difficulty encountered

in October of 1958 was not a basis for Andre to conclude that he was afflicted with an ailment or disease of the brain, when he had been presented with a negative encephalogram, when the condition had quickly cleared (Holliger deposition p. 33, ll. 10-26) and when he had the reassurance of a doctor's opinion that it had possibly been caused by a "spasm". (Holliger deposition p. 51, ll. 21-23.)

The answer to the question relating to a disease or ailment of the blood vessels must also be appraised in the light of the circumstances existing on January 20, 1959 and not be viewed in connection with a subsequent history or inquest. The applicant had never had high blood pressure, despite an erroneous indication in the records of Hahnemann Hospital. (Holliger deposition p. 41, ll. 22-23.) Whatever vascular problem may have been suspected at the time of the hospitalization was not of such a nature as to give the doctor cause for alarm. Dr. Holliger refers to a "little" rupture (p. 30, l. 26 Holliger deposition), the involvement of a "small" artery (Holliger deposition p. 31, l. 8), the "impression" of a "small CVA" (Holliger deposition p. 30, l. 23) and finally the impression of a "spasm of the blood vessel rather than actual injury to the blood vessel itself". (Holliger deposition p. 51, ll. 22-23.) It was the practice of the doctor to keep his patient informed (Holliger deposition p. 34, ll. 13-17) and we must assume that the information and opinions given to the patient would be no different than what was known and believed by the doctor himself.

There is no finding of falsity or intentional misrepresentation respecting any specific question relating to the heart. But from the finding (7) which recites the existence of symptoms and the advice of the doctor that such symptoms evidenced angina pectoris we must assume that the Court decided that the questions relating to the heart were falsely answered. It is undeniable in retrospect that a heart condition existed at the time of the application. But the law is well settled and most logical in its position that falsity cannot be demonstrated by subsequent events. (*Brubaker v. Beneficial Life Insurance Co.,* 130 C.A.2d 340; *Chase v. Sunset Mutual Life,* 101 C.A. 625.) We are here concerned with the then state of the record and Andre's best knowledge and belief as to his condition. Obviously his knowledge and belief were those of his physician as communicated to him. The deposition of doctor Holliger discloses diagnoses and opinions which would support the answers of the decedent to all of the questions of the application. An over-all optimism as to the condition of the patient pervades the deposition. At page 22, line 21, the doctor reassures the patient and tells him "not to be alarmed" because of a refusal of insurance. At page 28 at lines 14 and 16 the doctor refers to the "heart pain" episode as "impressions" and comments on line 20 "you may note that is the first time of any complaint of that," and commencing at line 26 of page 28 "the only notation we have of any difficulty there was in '57. There was no notation, there were no complaints after that time." On page 29, lines

3 through 8, the doctor again questions his working diagnosis of angina pectoris. When asked if, at and about the time of the Hahnemann Hospital visit Andre was taking medicine for a heart condition the doctor stated that he had neither prescribed nor asked the applicant to take medication. (p. 36, l. 25 to p. 37, l. 8.) The notes of the doctor for December 29, 1958 state: "Doing OK—no problems," and for February 6, 1959 "no problems. Reflexes okay." The reassurances given Andre by Doctor Holliger are comparable to those which the Court found to be persuasive of good faith in *Ransom v. Penn Mutual Life Ins. Co.* (43 C.2d 420).

On pages 50 and 51 of his deposition the doctor generally reviews his treatment and findings respecting the insured. He states in part (p. 50, l. 9):

> "Also I wish to note that he has no complaints from '39 up to . . . the time that he was last in this office, except for the one occurrence,"

and (p. 50, l. 14):

> "I will state this again: That at the time we made the diagnosis, December 30th, 1957, of one angina and coronary insufficiency, that this was our *impression* at that time."
>
> "Now, also let me state that whenever we take care of a patient with any symptom of chest pain, we'll always assume that it's the worst, and we'll treat them and put them under treatment for the worst possible condition that they could have."

As part of the processing of the application of January 20, 1959, Manhattan availed itself of the

authorization given by Andre and communicated with Doctor Holliger. The reply of the doctor (letter dated February 16, 1959, exhibit to La Pointe and Holliger depositions) states:

> "I have insisted on seeing Mr. Andre at regular intervals, but I have failed to demonstrate any cardiac disease."

The letter represents the doctor's appraisal of Andre's condition at the time of the application—his best knowledge and belief as the result of observations made over a period of ten years. That subsequent events proved both doctor and patient wrong is no evidence of bad faith or misrepresentation. What was represented was the best knowledge and belief of both—all that the application required—and all that the law demands.

(2) The Evidence, When Weighed With the Applicable Presumptions of Law Does Not Support the Finding That False Answers to Each of the Questions Referred to Were Knowingly Made in Bad Faith by the Insured. (Finding 8.)

Review of the evidence fails to fully support the objective findings as to the incorrectness of the representations made let alone the subjective findings as to knowledge and bad faith. As contended above, the facts taken alone do not warrant the conclusions made. They become wholly inadequate when considered in the light of the presumptions afforded by law.

By attempting rescission upon the ground of fraud the Insurer has taken upon itself the burden of proving an affirmative defense and overcoming a

presumption of law against fraud. As stated by Justice Lemmon in *Canada Life Assurance Company v. Houston* (9th Circ.) 241 F.2d 523:

> "In a case of this kind, the insurance company has the burden of proving fraud. As was said in *Truett v. Onderdonk* (1898) 120 Cal. 581, 588; 53 P. 26, 29, 'the presumption is always against fraud—a presumption approximating in strength that of innocence of crime'."

Little, if any, weight could have been given to this presumption if bad faith is deduced from such inconclusive facts. In view of the circumstance that all of the representations as to physical condition stem from and parallel the assurances and opinions of the doctor, conspiracy as well as bad faith must have been concluded. The difficulty experienced by the broker in selling insurance to Andre would also argue against a finding of fraudulent intent to obtain insurance. (Rep. Trans. p. 75, l. 22 to p. 76, l. 1.) The evidence from which a finding of bad faith has been drawn is too tenuous and too contradicted to offset the presumption against fraud.

(3) The Evidence Does Not Support the Finding That the Defendant Relied Upon the Representations of the Insured in the Issuance of the Policy. (Finding 11.)

The finding that the defendant relied upon the representations of the insured in issuing the policy disregards so many obvious facts as to be almost naivete. If the objectionable answers to certain questions in the application constituted the basis for the issuance of the policy what is there to justify the limitation

in the amount of insurance, the "rated" classification and the stepped up premium above and beyond the rated base. There is nothing in the "relied upon" application which would warrant such treatment.

> "It is a fundamental principle of the law of fraud that in order to secure redress, the party must have relied upon the statement or representation as an inducement to his action. The logical consequence of this rule is that the representee in order to render the representations actionable, must have been deceived by them, since the law will not permit one to predicate damage upon statements which he does not believe to be true." (169 A.L.R. 361).

There is no other interpretation of this record than that the insurer took a known and calculated risk. The policy in litigation is not a contract entered into by an unsuspecting insurer with a pristine prospect. We are here dealing with an acknowledged sub-standard risk upon damaged merchandise.

The defendant concedes that this contract was a "sub-standard risk" by designedly failing to reply to number (1) of Plaintiff's Request For Admission of Facts (Trans. p. 42). The acquaintanceship of the defendant and the insured was almost intimate. From an application filed with it in 1958 Manhattan knew that Andre had been rated in 1956 by Pacific Mutual Life Insurance Company and had been declined by another insurance company by reason of electrocardiogram findings. (Exhibit to La Pointe deposition.) With the record of past myocardial damage revealed by the records submitted in connection with the 1958

application the defendant requested and received of Doctor Holliger an electrocardiogram tracing of December 26, 1957 and concluded therefrom that the status of the applicant in 1958 was worse than in August 1956. (Exhibits to La Pointe deposition.) Suspicions of heart condition were well implanted in the records of Manhattan when the 1959 application of Andre came before it. Forearmed, it directed Doctor David Leigh Rodgers to subject the applicant to special tests, a chest x-ray, and an electrocardiogram, not normally given in connection with an application of the size being processed. (Rep. Tr. p. 75, ll. 4-21.) Significant also is the fact that Andre was no stranger to the examining physician. Doctor Rodgers had examined him in 1956 on behalf of Pacific Mutual and his findings had resulted in a "rated" policy. (Exhibit to La Pointe deposition.)

Even less convincing is the claim of reliance when it becomes obvious that the questions in controversy are answered in the handwriting of Dr. Rodgers, an agent of the insurer with a knowledge of facts inconsistent with the answers. (Exhibit B in evidence.)

Such facts would make it apparent that the answers complained of were not taken at face, or at any value. The conduct of the insurer confirms the point. When informed that a simultaneous application was being considered by Pacific Mutual predicated upon the same medical examination made by Doctor Rodgers, the defendant made a "target" of the companion application so as to have the benefit of Pacific Mutual's appraisal of the risk. (Rep. Tr. p. 73, l. 23 to p. 74,

l. 19.) Yet the adverse action of Pacific Mutual did not deter Manhattan from accepting the risk—inasmuch as Andre Paper Box Company had the financial responsibility to meet a stepped up premium. The real concern of Manhattan is indicated by its conduct in engaging the Retail Credit Company to investigate the financial stability of the applicant but not bothering to use the authorization given it by Andre to consult Doctor Holliger's records despite information giving real cause for suspicion of heart trouble. The correspondence and the EKGs of Doctor Holliger evidenced the concern of the applicant's physician as to the possibility of a heart problem. The disclosure that Canada Life Assurance Company had declined coverage by reason of cardiograph readings brought forth no inquiry as to what such files might contain. The report which Manhattan made to the Medical Information Bureau April 13, 1959 clearly shows that there was no misapprehension as to the quality of the commodity with which it was dealing—the analysis of the chest x-ray showed an amount of heart enlargement and the EKG taken by Doctor Rodgers on January 20, 1959 was described "T. wave unusual, peculiarity of S-T interval." (Plaintiff's Exhibit last in order.)

The answer of the defendant to interrogatory 16 propounded by plaintiff (Tr. pp. 28 and 31) concedes that it did not rely solely upon the representations made in the application. Answers to interrogatories 17 and 18 reveal that the company issued the policy in a reduced amount and at an increased premium

rate because of knowledge which it had from sources other than the application and which was contrary to the answers in the application.

The record is replete with facts which belie the purported reliance upon the questions of the written application. It is obvious that the insurer made its own appraisal of the health of the applicant, increased the premium to make the risk worthwhile, guessed wrong, and is now backing down on its undertaking with a claim of "foul."

As in *Weir v. New York Life Ins. Co.*, (91 C.A. 222, 230) the insurer knew of facts contrary to the representations in the application before issuing the policy and "issued it in a reduced amount and at an increased premium rate because of its knowledge."

(4) The Evidence Does Not Support the Finding that the Defendant Would Not Have Issued the Policy on Andre's Life Had It Been Aware of the True Facts Concerning his Physical Condition. (Finding 11.)

If there were any facts which the defendant did not know relative to the physical condition of the applicant such ignorance was self-induced. The attempt to hide behind a questionnaire which defendant knew was not even filled out by the applicant is most unconvincing. The insurer had ample warning of the risk involved, made a thorough examination on its own behalf, decided to issue the policy on a remunerative basis and then closed its mind to any further consideration of the matter. Its refusal to consult Pacific Mutual after the unfavorable action of such company upon the 1959 application is most indicative.

If any special circumstances existed which were known to Pacific Mutual, they were of no interest to Manhattan.

At all times this insurer could have declined coverage as others had done upon the same information possessed by Manhattan but despite knowledge sufficient to urge caution it persisted with the contract in the hope of monetary advantage. From the 1958 application it knew that Andre could not be forced to extremes and that the offer had to be made more attractive than the 1958 offer which Andre refused. The rating and policy limit of the 1959 contract are slightly better than the 1958 offer.

The conduct of the insurer in disdain of other possible facts is the most eloquent evidence pertaining to the portion of Finding 11 falling within the "had I known" category. The only other evidence purporting to touch upon this negative feature is the incompetent and self-serving statements of the company's medical officer which will be considered under a subsequent heading and the abstract testimony of Doctor Robbins who assumed that the only information in the files of the insurer was what was contained in the application and who had very limited experience in evaluating insurance risks (Rep. Tr. p. 91, l. 20 to p. 93, l. 3.) The inadequacy of Doctor Robbins' opinion may be demonstrated by his interpretation of the electrocardiogram taken by Doctor Rodgers on January 20, 1959. Doctor Robbins read the tracings as indicating a trend toward normal when compared with the tracing of December 1957.

The same electrocardiogram of 1959 prompted Pacific Mutual to reject the risk and caused Manhattan to comment upon the "unusual T. Wave" and the "peculiarity of S-T interval." (Plaintiff's exhibit last in order.)

The general inadequacy, if not irrelevancy, of Doctor Robbins' testimony is apparent from a full reading of the transcript. It is apparent that the Doctor is unaware that the hypothetical questions relate to an insurer dealing in sub-standard risks and that the problem is one relating to a sub-standard contract with a person well known to the issuer. He is apparently unfamiliar with "rated" policies and obviously was not informed that "uninsurable" persons are covered if the price is right.

The most vital and an invalidating objection to the testimony of Doctor Robbins is that it is predicated upon a false hypothesis. The questions posed assumed that Andre had sustained a cardiovascular accident and that he had experienced recurring chest pains during the year 1958. (Rep. Tr. p. 84, ll. 24-25; Rep. Tr. p. 86, l. 23.) In comparing the 1957 and 1959 cardiograms the doctor was under the impression that there was a history of recurring difficulty during the intervening period. This is contrary to the facts in evidence. The chest pain episode antedates the 1957 cardiogram and there is absolutely no evidence of any recurring pains during 1958. The testimony of Andre's attending physician, the only evidence on these matters, proclaims that in his best judgment, as of the time of the application, there was insuffi-

cient indication of a cardiovascular accident to support such a diagnosis, and that the 1957 chest pain attack was the only incident of such nature from 1939 until the last visit of Andre to the doctor's office, February 6, 1959. (Holliger deposition p. 28, l. 26 to p. 29, l. 2; p. 50, ll. 9-11.)

(5) The District Court Erred in Concluding That the Defendant Did Not Waive Its Right to Know the Facts and Did Not Neglect to Make Inquiry as to the Truth of Representations. (Conclusion of Law 3.)

The law will not permit an insurer to remain passive when it is in possession of information which should give cause to question the advisability of the risk which it is undertaking. The information in the possession of the defendant was a factor warranting the application of the doctrine of *Di Pasqua v. California Life Insurance Company,* 106 C.A.2d 281, placing upon the insurer the duty of further inquiry to ascertain the pertinent facts. The substantial record of Andre's heart condition warned Manhattan that answers in the questionaire were inaccurate. As stated by the Court in *Di Pasqua*:

> "The company was put upon notice prior to issuance of the policy that the answers of the insured could not reasonably be relied upon."

The written authorization from Andre to Manhattan affording access to the records of Doctor Holliger is a further fact in common with the *Di Pasqua* situation wherein the Court critically pointed out:

> "It had in its possession an authorization signed by the insured to obtain any medical information pertaining to him."

By its decision the Court there imposed upon the insurer the duty of exercising the authorization.

Circumstances present in the case here under consideration gave to Manhattan additional sources of information even more readily available. Manhattan was aware that Pacific Mutual had once rated and had then declined Andre and that Canada Life had refused him coverage. Yet no inquiry was made of either company to learn if such actions were predicated upon facts not known to Manhattan. The files of Manhattan further disclose a customary source of insurance information unavailed of. Membership in the Medical Information Bureau (Rep. Tr. p. 69 and exhibits La Pointe deposition) entitled Manhattan to receive the benefit of the files of all other insurers who had examined Andre. Manhattan transmitted what information it had evolved but asked for none. In the case of *Columbian National Life Insurance Co. v. Rodgers*, 116 F.2d 705, the Court held that information in the possession of an M.I.B. member prior to the issuance of a policy that an application had been made to another company and that such company had created a record was sufficient to put the insurer on inquiry.

The failure of Manhattan to explore any of the sources of information available to it gives further support to the contention of appellant that the appellee made its own examination, evaluated the risk and was not interested in the conclusions of others or in additional data. By its lack of diligence or obstinacy Manhattan foreclosed the right to claim it was misled by representations in the application.

(6) The District Court Erred in Admitting Into Evidence Against a Beneficiary With a Vested Interest, Declarations of the Decedent Not Made at the Time of Procuring the Policy and Not Part of the Res Gestae.

In the records of Hahnemann Hospital introduced through the deposition of Mary Moran and also incorporated in the depositions of Doctor Holliger and Doctor La Pointe are notations derived from declarations made by Andre. (Rep. Tr. p. 16, l. 9-13; page 3 of Hahnemann record.) Prescinding from the inaccurate reference to high blood pressure, which Andre did not have (Holliger deposition p. 41, l. 22) the history purports to be a recitation of statements made by Andre at the time of the admission to Hahnemann Hospital.

In the deposition of Doctor Holliger and in exhibits thereto are notations of conversations between the doctor and Andre purporting to record statements of Andre. (Rep. Tr. p. 28, l. 21 to p. 30, l. 2; p. 31, l. 24 to p. 32, l. 11—page 20 of Holliger records.)

In the exhibits to the Tuxbury deposition are found histories and a summary quoting or paraphrasing declarations of Andre. (Rep. Tr. p. 22, l. 12; p. 23, l. 3; p. 23, l. 12.)

Objection was duly made to the introduction of any of such evidence and the objections were overruled by the Order of Court on Objections. (Tr. pp. 49-50.)

The basis for the objections is that declarations of Andre not made at the time of the application for insurance and not forming a part of the res gestae of such transaction are inadmissible against the appellant as assignee of the owner-beneficiary of the

policy who held a vested interest. The principle of law supporting such objection is set forth in 29A *Am. Jur.* 944 § 1885:

> ". . . where the defense in an action on a contract of life insurance is based on the alleged falsity of statements contained in the application, admissions or declarations of the insured, whether made before or after the policy was issued are not admissible against a beneficiary, other than the estate of the insured, unless they were part of the res gestae."

California decisions support such rule. In *Yore v. Booth*, 110 Cal. 238, the insurer sought to introduce other applications made by the deceased which controverted the age represented in the application before the Court. It was held that any declarations of the deceased, not made at the time of procuring the policy, or as part of the res gestae, were hearsay and incompetent.

In *Jenkin v. Pacific Mutual*, 131 Cal. 121, declarations made by the deceased before his death tending to show that he contemplated suicide were held not competent evidence.

In *Paez v. Mutual Indemnity*, 116 Cal.App. 654, 661, the Court gave approval to *Yore v. Booth* and concluded:

> "In the instant case any statement made by the deceased after the issuance of the policy was not part of the res gestae and not binding on the plaintiffs herein and therefore not admissible."

The California decisions are crystallized in 28 *Cal. Jur.* 2d 379 § 608:

"Declarations of a decedent not made at the time of procuring a life insurance policy or as part of the res gestae are hearsay and incompetent as evidence against beneficiaries who have a vested interest in the policy." (*McEwen v. New York Life,* 42 C.A. 133.)

(7) The District Court Erred in Admitting Into Evidence the testimony of Doctor La Pointe That the Insurer Would Not Have Assumed the Risk Had Different Answers been Given in the Application.

Through the deposition of Dr. La Pointe the defendant would have us believe that had one or two questions in the application been answered differently it would not have issued the policy. (Rep. Tr. p. 48, l. 1 to p. 51, l. 19; Ruling—Tr. pp. 49-50.) In order to meet this issue head-on we will prescind for the moment from the lack of diligence on the part of defendant which kept it from ascertaining the information now purported to be so vital. Then let us first recall that Dr. La Pointe is the Medical Director of the defendant and is the ultimate judge of the insurability of applicants for life insurance. (La Pointe deposition p. 2.) Any testimony from this source that the policy would not have issued had he been apprised of other facts is an infringement upon the prerogative of the Court. Whether the facts allegedly concealed were of such import as to compel different conduct if known is a matter for judicial determination. Plaintiff recognizes that there is a conflict of authority upon the admissibility of evidence that the insurer would not have accepted the risk except for the misrepresentations. The greater

weight of authority holds such testimony to be incompetent. This would seem to be the better rule in view of the obviously self-serving and subjective nature of the testimony and the difficulty of controverting it. The logic of this position is well set forth in *Volunteer State Life Insurance v. Richardson,* 146 Tenn. 589; 244 S.W. 44:

> "It is not to be left to the insurance company to say, after a death has occurred, that it would or would not have issued the policy had the answer been truly given . . . no sound principle of law would permit a determination of this question merely upon the say-so of the company after the death has occurred."

It was stated in *New Era Assn. v. MacTavish,* 133 Mich. 68; 94 N.W. 599:

> "To adopt the theory of complainant (insurer) is to permit one of the parties to a contract to determine its construction.
>
> "The Insurer cannot be permitted to testify that he would not have taken the risk had he known the facts."

Other decisions supporting this viewpoint include:

Luke Grain v. Ill. Bankers, 263 Ill. App. 576;
Louis v. Connecticut Mutual, 68 N.Y.S. 683;
Mace v. Provident Life, 101 N.C. 122; 7 S.E. 674;
N. Y. Life Ins. Co. v. Carroll, 154 Okla. 244; 7 P. (2d) 440.

An opinion made pertinent by a parallel factual situation would also make the testimony of Dr. La

Pointe immaterial. In *Newton v. S. W. Mutual Life Assn.* (116 Iowa 311, 90 N.W. 73) the applicant had given a negative answer to the question "Has any company ever declined to grant insurance on your life?" The applicant had been denied coverage by the Woodmen of the World. It was determined that the question relating to "company" did not necessarily suggest the unfavorable action of the lodge. It is most comparable to the ambiguous question in the instant application which purports to relate to hospitalization. The Iowa court in construing the application against the insurer held:

> "If any construction can reasonably be put on the question and the answer such as will avoid a forfeiture of the policy on the ground of falsity of the answer, that construction will be given, and the policy will be sustained."

The Court further stated:

> ". . . if the answer complained of was not false, then it is wholly immaterial what the action of the medical director would have been had he known of facts not inquired about in the application."

(8) The District Court Erred in Admitting Into Evidence the Records of Presbyterian Hospital Relating to an Illness Occurring Subsequent to the Issuance of the Policy.

With the apparent purpose of proving false certain answers in the application of Andre, the insurer introduced through the deposition of Francis K. Tuxbury, the records of Presbyterian Hospital, in New York City, relating to a confinement of Andre occurring after the policy had been issued and delivered.

Objections to the introduction of the deposition as hearsay were made but by the Order on Objections (Trans. pp. 49-50) the records were admitted with the deletion of only the diagnoses.

The unfair import of such testimony is apparent and the law will not permit any inferences to be drawn from the subsequent occurrence of a condition denied to exist in the past. "The mere fact that the representations of the insured were proved to be unfounded by subsequent events, in the absence of fraud or deceit would not void the policy." (*Brubaker v. Beneficial Life Insurance Co.,* 130 C.A. (2d) 340; *Chase v. Sunset Mutual Life Assn.,* 101 C.A. 625.) The Court below in its order admitting the deposition into evidence states:

> "The remainder of said deposition and the exhibits offered and received therewith are admitted in evidence to show knowledge of the deceased at the time of his application for insurance." (Tr. p. 50.)

The facts of the subsequent occurrence are inadmissible to prove the objective fact of a pre-existing condition—yet they are admissible to prove the subjective fact of pre-existing knowledge of that condition!

The purpose for which admitted renders the ruling even more objectionable. The realization by Andre that he had suffered a severe heart seizure in March and that discomfort which he had experienced in the past was related to heart trouble does not establish the fact that in January Andre knew or believed that a heart condition existed. Viewed from a hospital

bed past episodes take on a significance not appreciated at the time of their occurrence. The March attack brought into focus prior circumstances, the true import of which was not apparent to Andre—nor to his attending physician who in February certified "I have insisted on seeing Mr. Andre at regular intervals but I have failed to demonstrate any cardiac disease."

(9) The District Court Erred in Giving to the Representations Made in the Application for Insurance the Weight of Warranties Contrary to the Express Provisions of the Policy.

Despite the obvious fact that the application had little or no persuasive influence upon the issuance of the policy (Defendant's answer to Interrogatory 16) the insurer has been permitted to avoid its obligation upon the pretext that it was misled by inaccurate answers to three questions in the application.

The contentions of the defendant below and the judgment of Court indicate that undue dignity was accorded to the answers. The policy in its General Provisions (Exhibit A) recites:

> "All statements made by, or by the authority of, the insured or the applicant for the issuance of this policy shall be deemed representations and not warranties."

The effect of such language is stated in *Couch on Insurance* (2nd Ed.) Vol. 7, § 37:121:

> "Where it is expressly provided that in the absence of fraud, statements made by the insured shall be deemed representations and not warran-

> ties, good faith is sufficient, although the statements may have been incorrect in fact."

The California case of *Wills v. Policy Holders Life Ins. Co.* (12 C.A. (2d) 659) states the law of this state in this regard:

> "The burden is on the defendant to prove that the statements of the insured contained in the application were not only untrue but that he knew they were false or at least had reasonable cause to believe they were false."

Further provisions of the insurance contract are perhaps even less demanding than the law. The application recites:

> "It is agreed as follows . . . (b) That all statements and answers in the application will be complete and true to the best knowledge and belief of the undersigned;"

Under its agreement with the insured the company was asking merely the best knowledge and belief of the applicant. Such is what it was given.

(10) The District Court Erred in Concluding That the Defendant Was Entitled to Rescind the Policy.

By interposing the affirmative defense of fraud the insurer undertook a burden of proof which it has not sustained. The defendant below was thus required to present evidence establishing the fraud and all of the constituent elements of fraud. (*Weir v. N.Y. Life Insurance Co.*, 1 C.A. (2d) 516.) These elements include *all* of the following:

(1) Misrepresentation

(2) Material Fact

(3) Intent to Deceive

(4) Reliance Upon the Misrepresentation

(5) Justification for Reliance

(6) Falsity

(7) Knowledge of Falsity by Party Making Representations

(8) Damage from Reliance

Appellant has demonstrated that all of such factors are not found in this record. Many are absent. Others are too inconclusive to satisfy the burden of proof to the degree demanded to offset the presumption against fraud.

We will not attempt a full review of the points developed above. However, a few of the basic errors should be recounted. In the over-all it should be apparent that the Court below applied to the facts a standard not warranted by the nature of the transaction. An eminently successful businessman who

was not seeking insurance, who was in fact a "hard sell", was importuned by an insurance broker for a period of eight years. (Rep. Tr. P. 64, l. 3; p. 75, l. 22 to p. 76, l. 1.) By reason of indications of heart trouble the broker had experienced difficulty in placing insurance on his prospect. In his predicament the broker approached Manhattan, a company engaged in the handling of sub-standard risks. The prospect was known to Manhattan from a previous application in which it had given him a rating so poor as to make unattractive the limited and costly policy which it offered him. Information in such previous application gave such indication of a cardiac condition that upon a 1959 application the company directed its examining physician to subject the applicant to extra and special tests to determine his physical condition. The physician who examined the applicant was the same doctor who had conducted the previous examination which was the basis for the prohibitive rating. A medical check list in the form of a questionnaire was filled out as part of the examination, the answers to questions being inserted in the handwriting of the doctor aware of the suspected condition. The examination was made conjointly for the benefit of Pacific Mutual, which company refused to issue a policy. The application disclosed that another company had refused him coverage. Manhattan was a member of an organization serving as a clearing house for medical information on life insurance applicants making accessible information in the files of other companies. Manhattan processed the application, rated the applicant because of his past

history and physical condition and because of "electrocardiographic abnormalities and abnormalities on his chest x-ray" (answer to plaintiff's interrogatory 17, Tr. p. 31) and charged the insured an excess premium in addition to the charge for the rated classification. Approximately thirteen months after the policy date and after the payment of two annual premiums, the insured died. The insurer was permitted to rescind the policy upon the ground of fraud—the incorrectness of the answers to several questions in the application—one of which is too ambiguous to be considered and the others relating to a heart condition of which it was already aware.

Such facts do not afford a right of rescission. It is apparent that the Court has viewed the situation as though a prime risk insurer were dealing with a strange applicant, having before it no more information than was contained in the application.

The conduct of the insurer in the light of the information in its possession and in the light of the accessibility of further information was not compliance with the diligence which the law demands under such circumstances. The rule announced in *DiPasqua v. Western States Life,* 106 C.A.(2d) 281, placed the duty of further investigation upon Manhattan. Failure to conduct the inquiry suggested by the facts and required by law foreclosed any right of rescission which might have existed.

As evidenced by the findings, in order to justify rescission the Court was required to reject the possibility of good faith upon the part of Andre. Review

of the record gives the impression that the presumption existing at law was applied conversely. Overlooked are the facts that Andre did not seek insurance and that every answer given by him, other than the ambiguous "asylum" question has the support, qualified though it may be, of his physician. If after ten years of observation Dr. Holliger was unable to demonstrate a cardiac disease, why should a layman be presumed to know that such condition existed?

The greatest gap, however, in the evidence exists in connection with the element of reliance. Obvious is the objection that if Manhattan did rely upon the answers in the application, it had no right to, in view of the knowledge already in its possession. That it did so rely is incredible as well as unsupported by the evidence. Its own admission that it did not rely "solely" on the application, the rated policy and excess premium not justified by the information found in the application, the thorough examination of Andre conducted by Doctor Rodgers upon direction of Manhattan, the knowledge of Manhattan of facts contradictory of answers of Andre and its reluctance to pursue the avenues of additional information are eloquent testimony that there was an absence of reliance. The only evidence indicating reliance is the self-serving and incompetent testimony of the Medical Director of the insurer who originally evaluated the risk and who now asserts that "had he known" he would have acted differently, and the testimony of a Doctor of limited experience who was given even more limited information and an hypothesis without foundation in fact.

It is respectfully urged that no grounds for rescission exist, that the judgment of the District Court is contrary to the evidence and the law and should be reversed.

Dated, San Francisco, California,
February 7, 1963.

JOHN F. O'DEA,
Attorney for Appellant.

CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN F. O'DEA,
Attorney for Appellant.

(Appendix Follows)

Appendix.

Appendix

	Offered	Received	Rejected
Policy	Rep. Tr. p. 12	Rep. Tr. p. 12	
Application for Insurance 1/20/59	Rep. Tr. p. 12	Rep. Tr. p. 12	
Death Certificate	Rep. Tr. p. 13	Rep. Tr. p. 13	
Coroner's Report	Rep. Tr. p. 13	Rep. Tr. p. 13	
Deposition Mary Moran Custodian of Records Hahnemann Hospital	Rep. Tr. p. 13 to p. 17	Rep. Tr. p. 18	Order of Court Objections Tr. pp. 49-50
Deposition Francis Taxbury, Custodian of Records Presbyterian Hospital	Rep. Tr. p. 18 to p. 23	Rep. Tr. p. 23	Order of Court on Objections Tr. p. 50
Deposition Doctor Holliger and Exhibits	Rep. Tr. p. 23 to p. 34; Rep. Tr. p. 56 to p. 57	Rep. Tr. p. 34 Tr. p. 50	Rep. Tr. pp. 58-60
Deposition Alvin J. B. Tillman, M.D.	Rep. Tr. p. 34	Rep. Tr. p. 36	Order of Court on Objections Tr. p. 51
Deposition Gordon LaPointe, M.D. and Exhibits	Rep. Tr. p. 36 to p. 52; Rep. Tr. p. 53 to p. 55	Rep. Tr. p. 52 Order of Court on Objections Tr. p. 51	Order of Court on Objections Tr. p. 51
Medical Information Bureau Code and Translations	Rep. Tr. pp. 54-55; Letters John F. O'Dea and James Thacher	Rep. Tr. p. 55	

No. 18,272

United States Court of Appeals

For the Ninth Circuit

GRACE TURNER,

Appellant,

vs.

THE MANHATTAN LIFE INSURANCE COMPANY, a New York Corporation,

Appellee.

APPELLEE THE MANHATTAN LIFE INSURANCE COMPANY'S PETITION FOR A REHEARING

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No. 18,272

United States Court of Appeals
For the Ninth Circuit

GRACE TURNER,	*Appellant*,
vs.	
THE MANHATTAN LIFE INSURANCE COMPANY, a New York Corporation,	*Appellee.*

APPELLEE
THE MANHATTAN LIFE INSURANCE COMPANY'S
PETITION FOR A REHEARING

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

Appellee requests a rehearing by this court limited to two issues:

(1) Under the doctrine of *noscitur a sociis*, as applied in this circuit, does the word "hospital" (as that word appears in question 19 of the insurer's application, i.e., "Have you ever been an inmate of, or received treatment or cure at any asylum, *hospital*, or sanitarium?"), refer *only* to a *mental* hospital in appellee's and all other similarly worded insurance applications?

(2) May the court, relying on inferences of its own contrary to the standard of appellate review in *this* circuit set forth in the recent case of *Lundgren v. Freeman*, 307 F.2d 104, (CA 9, 1962), set aside the specific findings of the trial court which are supported by uncontradicted testimony and reasonable inferences.

Turning to the first issue. The insured answered "No" to question 19 quoted above. The trial court, however, found that the insured was hospitalized in Hahnemann Hospital "within *four months* of the date of his application for insurance" (Finding 6); that accordingly, his answer of "No" to question 19 was "false" (Findings 1 and 2); and that his false answer "did not result from *inadvertence* or *misunderstanding*" of the question's purport . . . but was "*knowingly* made in *bad faith.*" (Finding 8.) The trial court also found that: "The defendant . . . relied on . . . such material misrepresentation and would not have issued the subject policy . . . had it been aware of the true facts concerning his physical condition which were *concealed* by his *misrepresentations.*" (Finding 11.) (Emphasis added.)

Suggesting that the moving force behind the insured's application was the pressure of the insurer's agents* (and

*The court apparently believes that because the insured's mortality rate was 350% of standard mortality, the premium charged

not the insured's need of obtaining "key-man" insurance as security for a loan to his company), the reviewing court overturned these specific findings as to falsity, bad faith, concealment and misrepresentations on the belief that the word "sanitarium" in question 19 referred to a *mental* sanitarium, and therefore, applying the doctrine of *noscitur a sociis,* the word "hospital" referred to a *mental* hospital.

But does the word "sanitarium" clearly refer to an institution for *mental* disorders? In the absence of any cited authority in the court's opinion, counsel can only turn to the recognized sources of the interpretation of language: the standard dictionaries, the medical dictionaries, the legal texts, the adjudicated cases, and, on a popular but nevertheless revealing level, the "yellow pages" of the San Francisco Telephone Directory.

Webster's Third New International Dictionary (1961) (2720 pages) defines sanitarium (sanatorium) as:

> "1: An establishment that provides therapy by physical agents (as hydrotherapy, light therapy) combined with diet, exercise, and other measures for treatment or rehabilitation. 2a: An institution for rest and recuperation esp. for invalids and convalescents. b: An establishment for the treatment of the sick *esp. if suffering from chronic disease* (as alcoholism, tuberculosis, nervous and mental disease) requiring protracted care." (Emphasis added.)

The leading medical dictionaries, the cases, and the classified section of the San Francisco Telephone Directory are *all* to the same effect. (See appendix.)

Nowhere has counsel been able to find authority for the limited construction given the word "sanitorium" (much less the word "hospital") by the court.

Moreover, to apply such a restricted meaning to these common English words, so that three mental institutions

---

was 350% of standard. (op. p. 7) This is incorrect. The premium charged ($1819.00) was $767.50 more than the standard premium of $1,051.50.

but *no general hospitals* are deemed referred to in the insurer's detailed medical questionnaire, is to unsettle every similarly worded insurance contract in this circuit and to permit insureds who have been hospitalized for alcoholism, tuberculosis, cancer, heart disease, etc., to avoid disclosure of such hospitalization in their applications for insurance—a situation well illustrated by the present case where plaintiff's "No" answer to question 19 prevented the insurer from contacting Hahnemann Hospital and obtaining the tell-tale record that the insured had suffered a stroke four months before his application for insurance.

To turn now to the question of whether, under Federal Rule 52(a), as applied in this circuit, *Lundgren v. Freeman, supra,* specific findings of the trial court supported by both uncontradicted testimony and reasonable and necessary inferences may be set aside in reliance on contrary inferences drawn by *this* court as to what *might* have been the testimony of an uncalled witness.

Question 16 of the insurer's application asked the prospective insured whether he had "ever suffered from any ailment or disease of . . . (b) the *heart, blood vessels* or lungs." The insured answered "No." The trial court found this answer was "*false*"; that it "did not result from *inadvertence* or *misunderstanding*" but was "*knowingly* made in *bad faith*"; and that the policy would not have been issued had the company "been aware of the true facts concerning his physical condition which were *concealed* by his misrepresentations." (Findings 4, 5, 8, and 11.) These findings are supported by substantial evidence and reasonable and necessary inferences.

There is no dispute that "In December, 1957, a little more than a year before the application, Andre experienced a ten-day episode of chest pains for which he consulted his doctor on December 26, 1957 and was advised by his doctor on December 30, 1957 that such pains constituted angina pectoris and resulted from coronary in-

sufficiency." (Finding 7.) And it is the uncontradicted testimony of the insurer's medical director, that the insurer had no knowledge that the insured ever had angina or chest pains—vital medical information, as pointed out by the three doctors who testified, in determining whether the insured had an "arrested" or "active" heart disease. (Dissenting opinion.)

The court does not dispute the materiality of the insurer's lack of knowledge of this episode. Instead the court, contrary to the inference of the trial court, infers that the examining doctor, who did not testify, was given such information by the insured but failed to pass it on to the company.

The trial court in its findings *necessarily* inferred no such information was given the examining doctor, and its inference being reasonable is not reversible on appeal even though in a trial *de novo* this court might infer otherwise. *Lundgren v. Freeman, supra.*

Specifically, question 12 of the insured's statements to the medical examiner asks "Have you ever . . . had an electrocardiogram? If yes, state when, by whom made and explain purpose?" The recorded statement of the insured is "Yes, Dr. Holliger." The court *assumes* this statement refers to the EKG made on December 26, 1957, the day the insured reported his chest pains to Dr. Holliger, his own doctor. It then makes the further and much more important assumption that the insured told the insurer's examining doctor of the angina attack *because* it would have been fraudulent for him not to have done so.

In assuming the EKG referred to in answer to question 12 was the one made in 1957, this court has overlooked the fact that Dr. Holliger made two other EKGs, one of which the examining doctor knew about. (p. 32 Ex. Holliger Dep.) But no matter which of the three Holliger EKGs was referred to, the trial court *necessarily* inferred the insured said nothing to the examining doctor about the angina attack.

This was a reasonable inference for the trial court to make in view of the fact the insured *stated* in his application that he had read the recorded answer and that it was "correctly written *as given.*"

Since nothing appears in the application about the angina attack, since the insured's doctor in his correspondence with the insurer did not disclose the angina attack (opinion, p. 4), and since the defendant's medical director testified he was given no knowledge of the angina attack (Dep. LaPointe, pp. 8, 9), it was perfectly reasonable and surely *not* clearly erroneous of the trial court to conclude that knowledge of the attack was knowingly withheld from the insurer (including its examining doctor) by the insured.

The clearly erroneous rule is the *only* standard of appellate review of trial court inferences in this circuit—anything else on *this* record is a trial *de novo.* Fed. Rule 52(a), *Lundgren v. Freeman, supra.*

But make no mistake, henceforth the court's opinion will be read as inexplicably discarding the *Lundgren* rule as the rule of appellate review of trial court findings based on written evidence and inferences of fact in insurance cases.

Because of the conflict between the court's opinion and the holding of another division of the court in *Lundgren v. Freeman, supra,* on the issue of appellate review of trial court findings based on both written evidence and inferences of fact, appellee suggests this re-hearing be held *en banc.*

Respectfully submitted,

James F. Thacher,
Thacher, Jones, Casey & Ball,
Attorneys for Appellee
and Petitioner.

(Appendix Follows)

Appendix.

Appendix

Dorland's Medical Dictionary, Twenty-third Edition (1961) (1598 pages) reads:

> "Sanatorium (L. *sanatorius* conferring health, from *sanare* to cure) L. an establishment for the treatment of sick persons, especially a private hospital for convalescents or those who are not extremely ill. The term is now applied particularly to an establishment for the open-air treatment of *tuberculous* patients. 2. a health station; a health resort in a hot region." (Emphasis added.)

41 C.J.S. p. 331:

> "A sanitarium is a sanatorium, and a sanatorium is a hospital. In ordinary acceptation, a sanitarium is an institution for the medical treatment of sick persons, as well as for ministering to related needs of the patients. A sanitarium is a health station or retreat; also a boarding-house or other place where patients are kept and medical and surgical treatment given." (cases cited.)

People v. Gold, 6 N.Y.S. 2d 264, 268, states:

> "A sanitarium, according to Funk and Wagnalls, is sometimes synonymous with sanatorium which is a health retreat; an institution for the treatment of disease or care of invalids and especially an establishment employing natural therapeutic agents or some specific treatment."

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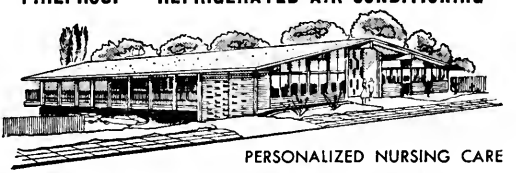

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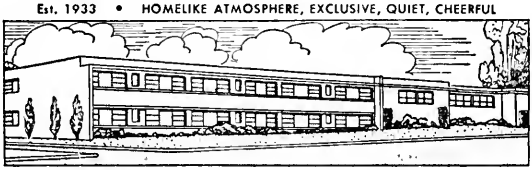

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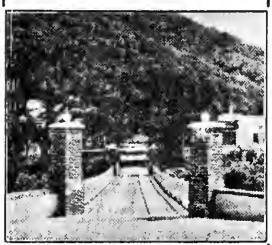

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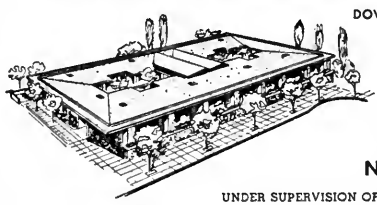

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No. 18273

In The United States Court of Appeals for the Ninth Circuit

HARVEY ALUMINUM (INCORPORATED),
GENERAL ENGINEERING, INC., AND
WALLACE A. UMMEL d/b/a WALLACE
DETECTIVE AND SECURITY AGENCY,

PETITIONERS,

vs.

NATIONAL LABOR RELATIONS BOARD,

RESPONDENT.

ON PETITION TO REVIEW NATIONAL LABOR RELATIONS BOARD ORDER

BRIEF FOR PETITIONER GENERAL ENGINEERING, INC.

RHOTEN, RHOTEN & SPEERSTRA
SAM F. SPEERSTRA
WILLIAM B. WYLLIE
Attorneys for Petitioner
General Engineering, Inc.
Pioneer Trust Building
Salem, Oregon

INDEX

TABLE OF CASES

STATUTES

TEXTS AND TREATISES

In the United States Court of Appeals for the Ninth Circuit

No. 18273

HARVEY ALUMINUM (INCORPORATED), GENERAL ENGINEERING, INC., AND WALLACE A. UMMEL d/b/a WALLACE DETECTIVE AND SECURITY AGENCY, PETITIONERS

vs.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

ON PETITION TO REVIEW NATIONAL LABOR RELATIONS BOARD ORDER

BRIEF FOR PETITIONER GENERAL ENGINEERING, INC.

JURISDICTIONAL STATEMENT

This case appears in this court on a petition for review and a cross-petition for enforcement of an order entered October 18, 1962, and corrected November 21, 1962, by the National Labor Relations Board (R. 129). The Board's order would require that General Engineering, Inc.:

(1) reinstate two employees with back pay;

(2) cease and desist from certain conduct; and

(3) post certain notices directed to its employees (R. 132).

The Board's order would also require the other petitioners herein to cease and desist from certain practices and would require the petitioner Harvey Aluminum (Incorporated) to take certain affirmative action including the posting of notices (R. 129-132).

The Board's jurisdiction was invoked under the Labor Management Relations Act, as amended, 61 Stat. 136, 29 USC 151, *et seq.*, and the regulations promulgated thereunder (R. 11-13).

General Engineering, Inc. is an Oregon corporation whose principal place of business is in Oregon, in this circuit (R. 11-13). The unfair labor practices alleged in the Board's complaint were alleged to have occurred at The Dalles, Oregon, and Torrance, California, in this circuit (R. 11-13).

On October 20, 1962, General Engineering, Inc. and the other petitioners herein filed a joint and several petition for review of the Board's order (R. 216).

On November 30, 1962, the Board filed a cross-petition for enforcement of its order (R. 220).

This court's jurisdiction accordingly rests upon 61 Stat. 148-149, 29 USC 160(e), (f).[1]

STATEMENT OF THE CASE

General Engineering, Inc. concurs in and adopts the brief filed by the other petitioners herein. Accordingly, this brief will be devoted only to those aspects of the case which relate peculiarly to this respondent.

During the proceeding before the trial examiner, counsel for the board requested that official notice be taken of prior board

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[1] Section 10 of the Act provides in material part:

"(e) The Board shall have the power to petition any Court of Appeals of the United States * * * wherein the unfair labor practice occurred or wherein such person resides or transacts business, for the enforcement of such order * * *."

"(f) Any person aggrieved by a final order of the board * * * may obtain a review of such order in any United States court of appeals in the circuit wherein the unfair labor practice in question was alleged to have been engaged in or wherein such person resides or transacts business * * *." 61 Stat. 148-149, 29 USC 160(e), (f).

decisions. These decisions were relied upon as showing such an inter-relationship between General Engineering, Inc. and Harvey Aluminum (Incorporated) that they should be treated as a single employer.

The first of these cases, a representation case, was decided in April of 1959 and is reported at 123 NLRB 586. The second, an unfair labor practice case, was decided in December of 1959 and is reported at 125 NLRB 674. The third case, an unfair labor practice case, was decided in May of 1961 and is reported at 131 NLRB 648. The fourth, an unfair labor practice case, was also decided in May of 1961 and is reported at 131 NLRB 901.

The record in the instant case contains no evidence as to the relationship, if any, between General Engineering and Harvey Aluminum. There is no evidence that the operations of General Engineering affect commerce within the meaning of the Act.

General Engineering, Inc. objected to the use of these decisions in exceptions to the trial examiner's intermediate report. General Engineering objected to the trial examiner's findings as to the relationship between General Engineering and Harvey Aluminum because they were not supported by substantial evidence. General Engineering objected to the trial examiner's findings that the Board had jurisdiction of General Engineering because there was no evidence that General Engineering's operations or activities, if any, could have affected commerce (R. 43).

Immediately after the decision of the trial examiner, and while the instant case was pending before the Board, General Engineering filed a motion with the board requesting an opportunity to refute the matters officially noticed. The Board denied this motion (R. 131, n. 6).

QUESTIONS PRESENTED

1. Whether the Board can take official notice of its prior decisions to establish facts which are adjudicative, disputed and critical.

2. Whether the Board having taken official notice of such facts may refuse to allow a party, upon timely request, to refute the noticed facts.

3. Whether the Board can assume jurisdiction over a corporation in a case in which there is no evidence as to the activities carried on by the corporation or that such activities, if any, could have any effect on commerce.

SPECIFICATION OF ERRORS RELIED UPON

1. The Board erred in taking official notice of prior decisions and in treating such decisions as evidence that this petitioner and Harvey Aluminum (Incorporated) constituted a single employer.

2. The Board erred in holding that this petitioner and Harvey Aluminum (Incorporated) constituted a single employer.

3. The Board erred in refusing to allow this petitioner an opportunity to refute matter officially noticed by the Board.

4. The Board erred in holding that it had jurisdiction of this petitioner and in failing to dismiss the complaint as against this petitioner.

NOTE: In the intesests of brevity this petitioner has assigned as error only those matters which relate peculiarly to it. In addition this petitioner concurs in and adopts the specification of errors relied upon by the other petitioners herein.

SUMMARY OF ARGUMENT

The Board officially noticed four of its prior decisions as establishing conclusions not based on facts appearing in the record. This petitioner made a timely request for an opportunity to refute the matter noticed. The request was denied. The Board's action violates the clear mandate of the statute requiring

that a party be given an opportunity to refute material, extra-record matter which is officially noticed. 5 USC 1006(d). The Board's decision violates due process. *Ohio Bell Telephone Co. v. Public Utilities Commission*, 301 U.S. 292, 302; 57 Sup. Ct. 724, 729 (1937).

General Counsel for the Board bears the burden of proving by a preponderance of the evidence that a party has violated the Act. He must bear this burden by evidence on the record. 5 USC 1006(d). Extra-record facts will not suffice. 29 USC 160(e).

Disputed, critical facts may not be officially noticed. The noticing of such facts deprives parties of the opportunity for cross-examination.

Conclusions may not be officially noticed. The evidential facts upon which the conclusions rest must be stated in order to permit the parties an apportunity to refute the noticed matter. *Ohio Bell Telephone Co. v. Public Utilities Commission, supra.* The parties are entitled to know the *evidence* with which they are confronted.

Prior Board decisions are not admissible in evidence. They are barred by the rule excluding hearsay and opinion evidence. If such decisions are to be given any effect in subsequent proceedings it must be based upon principles of res judicata.

Prior Board decisions can have no res judicata effect where the decisions are not final. None of the decisions relied upon by the Board in the instant case are final. Decisions can have no res judicata effect where the issues are different from those in the subsequent proceeding. A decision that Harvey Aluminum controls the labor relations policies of General Engineering, even assuming *arguendo* that it was correct in 1959, is not res judicata as to their relationship in 1961.

The Board has improperly relied upon official notice as establishing the identity of Harvey Aluminum and General Engineering. Upon this it has rested its jurisdiction of General Engineering. Substantial evidence on the record considered as a whole does not support the Board's decision and order as it relates to General Engineering. It is submitted that the

Board's decision and order should be reversed and the case dismissed.

I. Upon timely request parties must be afforded an opportunity to refute material facts officially noticed.

Assume for the purpose of argument that the Board may take official notice of its prior decisions as tending to establish material facts in a Board proceeding. The Board must permit the parties, on timely request, an opportunity to refute the matters noticed.

Professor Davis, in a discussion of official notice, declares:

> "The cardinal principle of a fair hearing is * * * that parties should have opportunity to meet in appropriate fashion all facts that influence the disposition of the case." 2 DAVIS, ADMINISTRATIVE LAW 432 (1958).

The failure to point out what *facts* are being noticed and to allow a party to rebut the noticed facts is a violation of due process. *Ohio Bell Telephone Co. v. Public Utilities Commission,* 301 U.S. 292, 302; 57 Sup. Ct. 724, 729 (1937).[2]

The Administrative Procedure Act contemplates that parties should have an opportunity to rebut all the material influencing the disposition of a case.[3] Section 7(d) provides parties an unrestricted right upon timely request to refute material matters officially noticed. That section provides:

> "Where any decision rests on official notice of a material fact not appearing in evidence in the record, any party

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[2] *Cf. ICC v. Louisville & Nashville R.R.,* 227 U.S. 88, 33 Sup. Ct. 185 (1913), in which the court declared:

"* * * the Commissioners cannot act upon their own information, as could jurors in primitive days. All parties must be fully apprised of the evidence submitted or to be considered, and must be given an opportunity to cross examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal. In no other way can a party maintain its rights or make its defense." 227 U.S. at 93, 33 Sup.Ct. at 187.

[3] Section 7(c) provides:

"Every party shall have the right to * * * submit rebuttal evidence, and to conduct such cross examination as may be required for a full and true disclosure of the facts." 60 Stat. 241, 5 USC 1006(c).

shall on timely request be afforded an opportunity to show to the contrary." 60 Stat. 241, 5 USC 1006(d).

The Board took official notice of four of its prior decisions for the purpose of showing that Harvey Aluminum (Incorporated) and General Engineering, Inc. were a single employer within the meaning of the Act.[4] Having determined in this manner that the two corporations were a single employer the Board held that since jurisdiction of Harvey Aluminum was proven it must have jurisdiction of General Engineering.

The petitioners made a timely request for an opportunity to refute the matters noticed.[5] The request was denied (R. 131, n. 6).

The noticed matter is material. Upon it rests, among other things, the Board's determination of its jurisdiction over General Engineering.

The facts noticed do not appear upon the record. Indeed, it is impossible to determine just what facts, if any, were noticed. So far as it appears in the trial examiner's intermediate report and in the Board's decision only conclusions were noticed. The facts, if any, upon which those conclusions rested are not stated (R. 131, 135). Both the trial examiner and the Board seem to be attempting, through the process of official notice to apply the otherwise inapplicable doctrine of res judicata.

The Board has officially noticed certain conclusions without stating the facts upon which it relied. This petitioner timely requested an opportunity to refute the noticed matter. Its re-

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[4] The decisions relied upon by the Board are reported at 123 NLRB 586, 125 NLRB 674, 131 NLRB No. 87 and 131 NLRB No. 108 (R. 135).

[5] The trial examiner took the disputed official notice in his intermediate report dated March 30, 1962 (R. 135). On May 18, 1962, the petitioners moved the Board, pursuant to 5 USC 1006(d) for an opportunity to refute the noticed matter. The deadline for filing exceptions to the intermediate report was May 18, 1962. Thus the request was filed before the Board could have commenced consideration of the case. Significantly, the Board did not rest its denial of the request upon its not being timely. The request must have been timely (R. 131, n. 6).

quest was refused. The statutory mandates of the Administrative Procedure Act as well as minimum standards of fairness have been ignored. This petitioner has been denied a fair hearing.

II. The Board cannot take official notice of its prior decisions to establish facts which are disputed and are critical.

A. The Board's findings in unfair labor practice cases must be based upon record evidence.

The Board's general counsel bears the burden of proving the allegations set forth in his complaint.[6] It must appear by a preponderance of the testimony taken that the respondent has committed an unfair labor practice.[7]

The general counsel must bear this burden by evidence on the record. Extra-record facts are not sufficient.[8]

In *Republic Aviation Corp. v. NLRB*, 324 U.S. 793, 65 Sup. Ct. 982 (1945), the court declared:

> "The method for prevention of unfair labor practices is for the Board to hold a hearing on a complaint which has been served upon the employer who is charged with the unfair labor practice. At that hearing the employer has the right to file an answer and give testimony. This testimony together with that given in support of the complaint, must be reduced to writing and filed with the Board. The Board upon that testimony is directed to make findings of fact

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[6] Section 7(c) of the Administrative Procedure Act provides:
"Except as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof * * *." 60 Stat. 241, 5 USC 1006(c).

[7] Section 10(c) of the Labor Management Relations Act provides:
"If upon the preponderance of the *testimony taken* the Board shall be of the opinion that any person named in the complaint has engaged in or is engaging in any such unfair labor practice * * *." 61 Stat. 147, 29 USC 160(c). (Emphasis added.)

[8] Section 7(d) of the Administrative Procedure Act provides:
"The transcript of testimony and exhibits together with all papers and requests filed in the proceeding, shall constitute the *exclusive* record for decision * * *." 60 Stat. 241, 5 USC 1006(d). (Emphasis added.)
Section 10(e) of the LMRA provides:
"* * * findings with respect to questions of fact if supported by substantial *evidence on the record* considered as a whole shall be conclusive." 61 Stat. 148, 29 USC 160(e). (Emphasis added.)

and dismiss the complaint or enter appropriate orders to prevent in whole or in part the unfair labor practices which have been charged. Upon the record so made as to testimony and issues courts are empowered to enforce, modify or set aside the Board's orders * * *

"Plainly this statutory plan for an adversary proceeding requires that the Board's orders on complaints of unfair labor practices be based upon evidence which is placed before the Board by witnesses who are subject to cross-examination by opposing parties. Such procedure strengthens assurance of fairness *by requiring findings on known evidence.*" 324 U.S. at 800-801; 65 Sup. Ct. at 986. (Emphasis added.)

The statutory procedure has been ignored. The Board has resorted to extra-record information in arriving at its decision. Its findings are not based on known evidence or on any evidence.

B. Facts which are adjudicative, disputed and critical may not be officially noticed.

In a discussion of official notice Professor Davis declares:

"When facts are (1) adjudicative (2) disputed and (3) critical nothing less than submission through evidence, subject to cross examination and rebuttal, will normally suffice.

* * *

The basic principle is that parties should have the opportunity to meet in the appropriate fashion all materials that influence decision. Nothing short of the opportunity for cross-examination and presentation of rebuttal evidence is appropriate for disputed facts at the center of a controversy." 2 DAVIS, ADMINISTRATIVE LAW 403-404 (1958).

This philosophy is clearly reflected in the Administrative Procedure Act. Section 7(c) requires that every party be given the right to submit rebuttal evidence and to conduct a cross-examination. 60 Stat. 241, 5 USC 1006(c). It is impossible to cross-examine or present rebuttal evidence when disputed, critical facts arising in an unfair labor practice proceeding are officially noticed.[9]

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[9] *ICC v. Louisville & Nashville R.R.,* 227 U.S. 88, 33 Sup. Ct. 185 (1913), *supra,* n. 2.

The Board took official notice of its prior decisions as establishing an identity between General Engineering and Harvey Aluminum. This issue was disputed. The Board's complaint alleged that the two corporations constituted a single employer. General Engineering denied this allegation. This issue was critical. Upon its determination rests the Board's jurisdiction over General Engineering.

III. Prior Board decisions are not admissible as evidence in subsequent proceedings.

A. Where the Board utilizes official notice it must inform the parties of the evidential facts noticed.

Conclusions may not be officially noticed. Agencies must state the evidential facts upon which such conclusions are based.

In *United States v. Abilene & Southern Ry.*, 265 U.S. 274, 44 Sup. Ct. 565 (1924), the examiner announced at the hearing that he intended to refer to the annual reports filed by the carriers involved. The ICC order rested in part upon data from the annual reports though the reports were not put in evidence. The court stated that the objection to the use of such material was "that the carriers were left without notice of the evidence with which they were in fact confronted as later disclosed by the findings made." 265 U.S. at 287, 44 Sup. Ct. at 570.

The case of *ICC v. Louisville & Nashville R.R.*, 227 U.S. 88, 33 Sup. Ct. 185 (1913), held that the parties must have an opportunity to know and to meet the information considered by the agency.

In *Ohio Bell Telephone Co. v. Public Utilities Commission*, 301 U.S. 292, 302, 57 Sup. Ct. 724, 729 (1937), the court held that the refusal to permit the company to explain or rebut extra-record statistics was a denial of due process. The court specifically pointed out that "even now we do not know the particular evidential facts of which the commission took judicial notice." *Id.* 301 U.S. at 302, 57 Sup. Ct. at 729.

In the instant case the trial examiner took official notice of four prior Board decisions as showing that Harvey Aluminum

and General Engineering were a single employer (R. 135). He did not notice any facts as supporting this conclusion. General Engineering has not been informed what facts were noticed and has been denied an opportunity to refute noticed conclusions.

B. Prior Board decisions fall within the rule excluding hearsay and opinion evidence.

Proceedings before the Board shall, so far as practicable, be conducted in accordance with the rules of evidence applicable in the federal district courts. 61 Stat. 146, 29 USC 160(b). No reason was advanced by either the trial examiner or by the Board why these rules of evidence should not have been followed in the instant case. Nevertheless they were not.

The judgments of courts determining issues of fact are not received in other suits as evidence of the facts so found. 5 WIGMORE, EVIDENCE, Sec. 1346(a) (3d ed. 1940); MCCORMICK, EVIDENCE, Sec. 295 (1954). Their use in court has been guided by principles of res judicata. The earlier findings come in, if at all, not as evidence but as a conclusive determination of issues. *Id.*

In *Universal Airlines v. Eastern Airlines,* 188 F.2d 993, 1000 (D.C. Cir. 1951) the court declared that the prior decision of an administrative agency is inadmissible because "it falls within the rule which excludes hearsay and opinion evidence."[10]

The court in *NLRB v. Bill Daniels, Inc.,* 202 F.2d 579 (6th Cir. 1953), *reversed on other grounds,* 346 U.S. 918, 74 Sup. Ct. 305 (1954), held that it was error for the Board to take official notice of its prior decisions.[11]

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[10] The court declared:

"The rights of the parties are to be determined by testimony adduced at the trial according to the rules of examination and cross-examination." 188 F.2d at 1000.

[11] On petition for rehearing the court declared:

"The Board contests this ruling upon the ground that it is entitled to take judicial notice of its own records. It is a general rule that a court will ordinarily not, either upon its own motion or upon suggestion of counsel, take judicial notice of records, judgments and orders in other proceedings, even though such case may be between the same parties and in relation to the same subject matter." 202 F.2d at 586.

In the instant case the trial examiner and the Board took official notice of prior Board decisions and treated them as evidence. In none of the noticed cases had the matter in issue in the instant case been decided. That issue was the relationship of General Engineering and Harvey Aluminum during the period the unfair labor practices alleged in the complaint in the instant case were supposed to have occurred.

C. Prior Board decisions can have no res judicata effect where the decisions are not final and where the issues differ from those in a subsequent proceeding.

Only final "judgments" have any res judicata effect. 2 DAVIS, ADMINISTRATIVE LAW, 584 (1958); RESTATEMENT, JUDGMENTS, Sec. 1 (1942).

Of the four cases officially noticed by the trial examiner none has become final. One was a representation case.[12] A Board order in a representation proceeding is not final order. *Leedom v. Kyne,* 358 U.S. 184, 187; 79 Sup. Ct. 180, 183 (1958). Another was settled.[13] The third was reversed in part and remanded for further proceedings. *General Engineering v. NLRB,* 311 F.2d 570, 574 (9th Cir. 1962).[14] The fourth was settled "without prejudice."[15] A case which is dismissed "without prejudice" cannot be taken to have established any fact and cannot be res judicata. *Hastings Mfg. Co. v. FTC,* 153 F.2d 253 (6th Cir. 1946); *cert. denied* 328 U.S. 853, 66 Sup. Ct. 1344 (1946); *Parke, Austin & Lipscomb v. FTC,* 142 F.2d 437 (2d Cir. 1944);

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[12] 123 NLRB 586

[13] 125 NLRB 674

[14] The Board's decision is reported at 131 NLRB 648 (131 NLRB No. 87)

[15] 131 NLRB 901 (131 NLRB No. 108). This court on January 31, 1962, by Judges Hamley, Morrill and Duniway in case number 17481 entered an order providing:

"* * * it is ordered that the petition for review and the cross petition for enforcement be and the same hereby are dismissed without prejudice to any party."

cert. denied 323 U.S. 753, 65 Sup. Ct. 86 (1944); 2 DAVIS, ADMINISTRATIVE LAW, 584 (1958).

Thus, none of the decisions relied upon by the trial examiner and the Board have yet become final. In every case relied upon by the trial examiner, except the representation case, official notice was taken of the earlier cases and was relied upon as establishing the relationship between General Engineering and Harvey Aluminum.[16]

In order to find that two corporations are a single employer within the meaning of the Act the Board must find that one employer controls the labor relations policies of the other. *NLRB v. Condenser Corp. of America,* 128 F.2d 67 (3d Cir. 1942). A finding that these employers occupied such a relationship at one time does not prove and does not result in collateral estoppel as to their relationship at some subsequent time. Unless the issues in two proceedings are identical the issues determined in the first proceeding can have no res judicata effect in the second. *FTC v. Raladam,* 316 U.S. 149, 150-151; 62 Sup. Ct. 966, 968 (1942).

The Board has attempted through the use of official notice and through its refusal to permit this petitioner to refute the matters noticed to give a res judicata effect to decisions which were not final in cases where the issues decided differed from those in the instant case.

This petitioner has been denied a fair hearing.

IV. The Board's findings that Harvey Aluminum and General Engineering are a single employer and that the activities of General Engineering affect commerce are not supported by substantial evidence on the record considered as a whole.

The Board's findings must be supported by "substantial evidence on the record considered as a whole." 61 Stat. 147,

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[16] The representation case is the first reported case where this issue was raised. 123 NLRB 586 (1959).

29 USC 160(c). Substantial evidence is well defined in *Universal Camera Corp. v. NLRB,* 340 U.S. 474; 71 Sup. Ct. 456 (1951), where the court declared:

> "* * * substantial evidence is more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. [citations omitted] Accordingly, it must do more than create a suspicion of the existence of the fact to be established * * *" 340 U.S. at 477; 71 Sup. Ct. at 456.

The phrase "on the record considered as a whole" means not only the evidence which supports the decision but that evidence which fairly detracts from it. *Id.* 340 U.S. at 490; 71 Sup. Ct. at 466.

For the reasons stated earlier in this brief the Board and the trial examiner improperly relied on official notice of prior decisions of the Board. There is no record evidence supporting the Board's findings and conclusions that Harvey Aluminum and General Engineering are a single employer. There is no record evidence that could form the basis for a finding that the activities of General Engineering, if any, affect commerce within the meaning of sections 2(6) and (7) of the Act. 61 Stat. 138, 29 USC 152(6) (7). The record does not support the Board's assumption of jurisdiction of General Engineering.

CONCLUSION

For the reasons stated it is respectfully submitted that the Board's order as it relates to General Engineering, Inc. should be reversed and the case dismissed.

RHOTEN, RHOTEN & SPEERSTRA

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General Engineering, Inc.

July 1963

CERTIFICATE

I certify that in connection with the preparation of this brief I have examined Rules 18 and 19 of this Court and that in my opinion the foregoing brief is in full compliance with those rules.

WILLIAM B. WYLLIE
Attorney

No. 18273

In the United States Court of Appeals for the Ninth Circuit

HARVEY ALUMINUM (INCORPORATED), GENERAL ENGINEERING, INC., AND WALLACE A. UMMEL d/b/a WALLACE DETECTIVE AND SECURITY AGENCY, PETITIONERS

v.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

ON PETITION TO REVIEW AND ON CROSS-PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

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INDEX

715-700—63——1

AUTHORITIES CITED

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Cases—Continued

Cases—Continued

Statutes:

In the United States Court of Appeals for the Ninth Circuit

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HARVEY ALUMINUM (INCORPORATED), GENERAL ENGINEERING, INC., AND WALLACE A. UMMEL d/b/a WALLACE DETECTIVE AND SECURITY AGENCY, PETITIONERS

v.

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BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court upon the joint and several petitions of Harvey Aluminum (Incorporated), General Engineering, Inc., and Wallace A. Ummel d/b/a Wallace Detective and Security Agency, to review and set aside an order of the National Labor Relations Board issued on October 18, 1962. In its answer, the Board has cross-petitioned for enforcement of its order. The Board's decision and order (R. 129–215)[1] are reported at 139 NLRB 151. This

[1] References designated "R" are to Volume I of the record reproduced pursuant to Rule 10 of this Court. References des-

Court has jurisdiction over the proceeding under Section 10(e) and (f) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 151, *et seq.*), the unfair labor practices having occurred at The Dalles, Oregon, and Torrance, California. Only General contests the Board's assertion of jurisdiction. This issue is discussed, *infra,* pp. 20–24.

COUNTERSTATEMENT OF THE CASE

I. The Board's findings of fact

Briefly, the Board found that Harvey and General (herein referred to jointly as "Harvey") violated Section 8(a)(1) of the Act by engaging Wallace to place labor spies among Harvey's employees in its plants at Torrance, California, and The Dalles, Oregon, in order to learn and report on the identity of those of its employees who favored union organization.[2] The subsidiary facts upon which this finding is based may be summarized as follows:

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ignated "Tr." are to the reporter's transcript of testimony. Whenever in a series of references a semicolon appears, those preceding the semicolon are to the Board's findings; those following are to the supporting evidence.

[2] The Board also found that Harvey violated Section 8(a)(3) and (1) of the Act by discriminating with respect to the employment of Ballard Dillon and Lewis D. Rea (R. 132, 194–209). Subsequent to the filing of the petition to review and the cross-petition to enforce the Board's order, the parties entered into a stipulation eliminating this portion of the case from the proceedings before the Court, on the grounds that Harvey had performed all the steps required by the Board to remedy its conduct toward these two employees which the Board found to be illegal. This stipulation was approved by the Court on May 28, 1963.

A. The employment of Wallace by Harvey

On June 2, 1960, Frank V. Siemens, a salesman for Wallace, called upon Andrew Cronkrite, general manager of Harvey's plant in The Dalles, Oregon (R. 137; Tr. 1708, 3344). Siemens first attempted to sell Cronkrite the detective agency's uniformed guard service. When Cronkrite advised Siemens that Harvey's own guard service was functioning satisfactorily, Siemens then stated that Wallace did other types of work as well (R. 137; Tr. 492). Cronkrite pointed to the notation, "confidential investigations," on Siemens' business card and asked how confidential these investigations could be. Siemens replied, "Very confidential" (*ibid.*). After some further discussion, Cronkrite asked if Wallace had personnel trained to "conduct a very quiet investigation into prounion employees of the Harvey Aluminum plant; and if [Wallace] had adequate * * * trained personnel to handle such a job * * *. He was very concerned about union conditions there at The Dalles * * *. He said he wanted to ferret out the union bastards * * *. He was going to fire them" (R. 137; Tr. 493–494).

Cronkrite went on to explain that Wallace operatives could be hired by Harvey as production workers through normal hiring procedures, after which they would be in position to make reports on their observations (R. 13; Tr. 494). Siemens assured Cronkrite that Wallace had personnel equipped to carry on this work. Cronkrite then stated that if Wallace did a good job at The Dalles, it could receive an identical assignment for Harvey at its plant in Torrance, Cal-

715-700—68——2

ifornia (R. 137; Tr. 493). The matter was left on the basis that they had a binding agreement if Cronkrite had a satisfactory conversation with Wallace A. Ummel, the proprietor of the detective agency, concerning price and availability of personnel (R. 137; Tr. 494).

After his meeting with Cronkrite, Siemens, accompanied by his wife and Gerald McCarthy, Ummel's lieutenant, reported to Ummel about this prospect (R. 142; Tr. 495–496, 498). They discussed ways in which they might place Wallace operatives in the plant, how the operatives could communicate the information they might acquire to Ummel and Cronkrite, and the various Wallace employees who might be suitable for such an assignment (R. 143; Tr. 497–498, 3350, 3354–3356). Within the next several days, Ummel and Cronkrite met and reached agreement on method and terms (R. 156; Tr. 43).

B. Labor espionage at The Dalles

Shortly after Harvey retained Wallace, Ummel approached Calvin Davis and asked if he was interested in working for Harvey at The Dalles (R. 148; Tr. 38). Ummel stated that Harvey was nonunion, that unions had been unsuccessful in organizing the concern, and that the job involved ascertaining the identities of prounion employees and reporting their names and badge numbers to Ummel or to Cronkrite (R. 148; Tr. 38). Davis accepted the proposition and was told that his job, as well as that of his companion, Darrel Wagner, was to "report any activities of tool theft and the prounion activity" (R. 148; Tr. 36).

On June 6, Ummel introduced Davis and Wagner to General Manager Cronkrite who instructed them to apply for work at Harvey through regular channels and, after hire, to listen for "prounion" discussions (R. 156; Tr. 43). He further told them that their sole purpose was to "ferret out all prounion men," and that they were to report these men to Cronkrite or Ummel, but preferably the latter, unless it was an emergency (R. 156; Tr. 44). Cronkrite also instructed them that, if discovered, they were to state that they had been employed for detecting "tool theft only" (*ibid.*). The next morning, Davis and Wagner applied for work at the Harvey employment office in The Dalles (R. 156; Tr. 45). They were hired as laborers on June 9 and assigned to different parts of the plant (R. 156; Tr. 45).

About two weeks later, Cronkrite asked Ummel to furnish two additional operatives (R. 156; Tr. 1820). Ummel promptly arranged for two of his employees then working as uniformed guards, Stanley Hahn and William Miller, to report to The Dalles (R. 156; Tr. 1822). They applied for work on June 22 and were hired in the same manner as Davis and Wagner (R. 156; Tr. 1821–1822).

All four operatives, following the instructions given them by Cronkrite and Ummel, detected and reported to Davis anyone who disclosed prounion sympathies (R. 156; Tr. 48–49). Davis would then meet with Ummel, or report to him by telephone, and transmit all the information about union activities which the undercover agents had learned (R. 156–157; Tr. 48,

50). Ummel forwarded to Cronkrite all information submitted to him by his operatives. As described, *infra,* Davis was transferred to the Harvey plant in Torrance, California, on July 26, 1960. Thereafter, the reports of the remaining operatives were given either directly to Ummel, or to Ummel's aide, Eugene McCarthy (R. 171, 158; Tr. 304–306).[3]

C. The spy system is extended from The Dalles to Harvey's plant in Torrance, California

As a result of conversations in the first part of July between Cronkrite and Albert Hinz, Harvey's Director of Industrial Relations, Harvey decided to have Wallace extend its espionage activities to the Harvey plant in Torrance, California (R. 172; Tr. 1911–1912). It was arranged between Hinz, Cronkrite and Ummel that two Wallace operatives would promptly proceed to the Torrance plant (R. 172; Tr. 1914–1916, 1918). Petitioners agreed that the undercover agents would report to Ummel in Portland by mail, or in emergencies, by telephone; that Ummel would then relay the information to Cronkrite at The Dalles; and that Cronkrite would use a Company tie-line to report this information to Hinz back in Torrance (R. 172; Tr. 1995, 2664–2665).

Cronkrite and Ummel, believing that Davis had been doing a good job at The Dalles, decided to select him to start up the California portion of the "investiga-

[3] Wagner worked until July 15, when he left voluntarily for other employment. Hahn, a college student, remained at The Dalles for "a little over 2 months" until he left to return to school. Miller worked until September 1, 1960, when Ummel returned him to uniformed guard service in Portland (R. 150).

tion" (R. 172; Tr. 1915, 2662). Accordingly, on July 21, Ummel met with Davis and instructed him to get a leave of absence from the plant in The Dalles, and report to the Harvey plant in Torrance along with Richard Moore, who was then working for Ummel as a uniformed guard in Portland (R. 172; Tr. 50, 1914–1915). Ummel told Davis that he and Moore should apply for work in the same manner as at The Dalles, and to carry on the same labor espionage assignment (R. 172; Tr. 50).

Davis and Moore applied for work at the Torrance plant on July 25, as instructed, and they were hired the next day (R. 173; Tr. 54–55, 373). In Torrance, as in The Dalles, all investigative reports were channelled through Davis. When Davis subsequently left Torrance, Moore transmitted all reports (R. 174; Tr. 58, 378–379). The men gave to Ummel names and badge numbers of all Harvey employees who voiced prounion opinions (R. 174–175; Tr. 377, 381–382).

On August 12, Lucier and Moles, two additional operatives who had been sent to Torrance, reported at the plant (R. 175; Tr. 56–57). They were joined by still another undercover agent, Madge Pesek, on August 22.

By the time Pesek arrived, Davis had gone back to The Dalles, having been warned by Ummel, Cronkrite and Hinz on August 16 that his role as an undercover agent had been discovered (R. 175; Tr. 60). Cronkrite arranged to have Davis get his old job back at The Dalles plant, but his reappearance aroused the suspicions of his co-workers there, and he left after one day (R. 175; Tr. 62–63).

Shortly thereafter, Ummel instructed Davis to return to Torrance—not to work at the Torrance plant, but to check on the operatives because some of them were not sending in reports (R. 176; Tr. 63, 65, 67). Davis arrived in Torrance during the Labor Day weekend and stayed there for a week. He sent Lucier and Moles back to Portland for nonproduction of reports, and had Ummel replace them with Tom Feazle and Ummel's brother, Ray Ummel (R. 176; G.C. Exh. 4). All of the operatives made reports to petitioners, via Moore, on the union sympathies of Harvey employees (R. 177; Tr. 378–379). Feazle stayed at the Torrance plant until September 29; Pesek and Ray Ummel left on September 30; and Moore left during the first week of October, when he resumed his duties as a uniformed guard for Wallace in Portland (R. 177–178; Tr. 385–386).

With Moore's departure from the Torrance plant, the only Wallace operative left in either of Harvey's plants was one Carl Stark, who was assigned by Ummel to The Dalles plant in September after all the other agents there had departed and the undercover work at the Torrance plant had been exposed (R. 177–178, 164, 156). He remained there until April 1, 1961, at which time he left of his own accord (R. 156). Unlike his predecessor agents, Stark reported exclusively about thefts of tools and supplies, and made no mention of union activities (R. 164; Wallace Ext. 3–17). Except for one possible reprimand, no action was ever taken by Harvey against any of the employees identified as thieves in Stark's reports (R. 168; Tr. 2645–2651, 2724–2725).

II. The Trial Examiner's procedural rulings

Since petitioners devote virtually their entire brief to the alleged prejudicial errors committed by the Trial Examiner and affirmed by the Board, we shall set forth in this section of the Statement the relevant portions of the unfair labor practice hearings out of which petitioners' complaints arise.

At the hearing on June 14, 1961, Calvin Davis testified that, prior to the hearing, he had given statements bearing on the subject matter of his testimony to agents of the Deparment of Labor and Federal Bureau of Investigation, as well as to agents of the Board (Tr. 113, 115).[4] Mr. Lubersky, one of petitioners' counsel, thereupon demanded that Mr. Henderson, counsel for the General Counsel, give him copies of the statements given by Davis to the Board, the Department of Labor and the FBI (Tr. 116). Pursuant to the proviso in Section 102.118 of

[4] In their brief, p. 48, petitioners assert that there is nothing in the record to show why these other agencies were interested in this case, thereby seeking to imply that they were merely helping the Board in preparing for this unfair labor practice hearing. The record shows, however, that counsel for petitioners were well aware that a complaint had been filed with the Department of Labor's Bureau of Labor-Management Reports alleging that Harvey had failed to report the money paid to Wallace for labor espionage, in violation of Section 203 of the Labor-Management Reporting and Disclosure Act (29 U.S.C. Sec. 433). See Tr. 114, 144. Since the violation of Section 203 is a criminal offense, and can also be remedied or prevented by a civil action brought by the Secretary of Labor (see Sections 209–210 of the LMRDA, 29 U.S.C. Secs. 439–440), it is readily apparent why the Departments of Labor and Justice were investigating.

the Board's Rules and Regulations, Series 8, as amended,[5] Henderson gave Lubersky copies of the two statements Davis had given Board agents. Henderson told Lubersky that the General Counsel did not have the statements Davis gave to the other federal agencies (Tr. 116, 128).

Lubersky then asked the Trial Examiner to put Henderson on the stand for "a sort of voir dire" on the statements given by Davis to Labor and the FBI; Lubersky claimed that he wanted sworn testimony on whether agents for the Board had copies or summaries of those statements, or had ever seen them (Tr. 117–118). However, when Henderson told Lubersky that under the Board's rules, he could not testify without permission of the General Counsel, Lubersky indicated that he knew that rule, but said: "* * * I think I should have an opportunity to put my questions, one right after the other on the record, and if he wants to say * * * 'I cannot answer,' that's fine, but I would like all my questions on the record" (Tr. 119). Thereupon, Henderson took the stand and, pursuant to Section 102.118 of the Board's rules, declined to answer a series of questions asked by counsel for Harvey, except that he repeated under oath the statement he had made before—i.e., that the General Counsel did not possess, or have under his control, any statement given to the FBI or Labor which came within the proviso to Section 102.118, or any copies or excerpts from such a statement (Tr. 120–130).[6]

[5] That section is reproduced at pp. 126–127 of petitioners' brief.

[6] Petitioners' allegation in its brief, p. 10, n. 9, that Henderson had not denied having the FBI and Labor statements in his possession, is incorrect.

When Lubersky had finished interrogating Henderson, he renewed his demand for the statements given Labor and the FBI, alleging that he "knew" that agents of the General Counsel had notes of those statements (Tr. 131). In the alternative, Lubersky moved that Davis' testimony be stricken (Tr. 132, 135). The Trial Examiner denied the motions (Tr. 135). Lubersky thereupon secured the issuance of *subpenas duces tecum* to Henderson, the Board's General Counsel, the Secretary of Labor, and the Attorney General, requiring each of them to produce (Tr. 136, 141, TX Exh. 1a, 1b and 1c):

> Statements or copies of statements taken from Calvin C. Davis, Richard W. Moore, Stanley R. Hahn and Gordon Bishop and notes, excerpts or summaries thereof and any summaries of oral statements or other records of interviews and writings with respect to any such oral statements made by any of the aforementioned to the extent that any such writing, memorandum or other document relates to the employment of any of the aforementioned individuals by Wallace A. Ummel or Wallace A. Ummel d/b/a Wallace Detective & Security Agency, or Harvey Aluminum (Incorporated), Harvey Aluminum of Oregon or General Engineering, Inc.[7]

The Trial Examiner examined Henderson as a witness to insure that everything which might be considered a "statement" had been produced, including notes or transcriptions of oral statements (Tr. 136–138). Henderson denied that he had "anything of

[7] In their brief, p. 12, petitioners erroneously state that the subpenas were issued on June 21. The correct date in June 14.

an unsigned nature * * * in the nature of a statement," but at the request of the Trial Examiner, agreed to search his files for memoranda of conversations with Davis, since they might "approximate a statement" (Tr. 138–143). The hearing recessed a few moments later, and the Trial Examiner again urged Henderson "to utilize the period * * * to go through his file and * * * instructing [him], if he has anything in his file which he feels corresponds to an affidavit, whether signed or not * * * [including] a recording of what the witness said * * * to bring it to [the Trial Examiner's] attention" (Tr. 147). After the recess, Henderson advised the Trial Examiner and petitioners that there was nothing in the file with respect to Davis which even came close to being a statement—or, in the words of Lubersky, "no reports, in other words, which purport to state in writing anything that Mr. Davis said to any representative of the Board" (Tr. 148).

Counsel for petitioners having accepted Henderson's word that he had produced everything which might even arguably be considered a "statement," the parties turned to the next witness, Stanley Hahn. On cross examination by Lubersky, it was ascertained that he had given a statement to the Board and a statement to the Department of Labor—none to the FBI (Tr. 323–324). The parties then stipulated that if Henderson were called to the stand, he would give the same answers regarding Hahn's statements as he had regarding Davis' (Tr. 330).[8] Henderson then gave

[8] Petitioners had not yet asked the General Counsel to give Henderson permission to testify.

Lubersky a copy of Hahn's statement to a Board agent and stated that he also had a "memorandum to file" concerning a conversation which Board Agent Stratton had had with Hahn, but which Hahn had never seen (Tr. 330–331). While contending that the memo was not a "statement" within the meaning of Section 102.118, Henderson nevertheless gave it to the Trial Examiner so that the latter might examine it *in camera* and rule whether all, or any part of it, was producible (Tr. 331–333).

The Trial Examiner's initial reaction was that while only "two two-word phrases" contained in the memo were producible under the *Jencks* line of cases,[9] they would be difficult to excise and therefore, he would "resolve the doubt in favor of [petitioners] and let them see it" (Tr. 333). Having thus won this favorable ruling from the Trial Examiner, Lubersky did not immediately accept the memorandum, but suggested that the Trial Examiner first compare the memorandum with Hahn's affidavit "to see if there is anything in here that goes beyond what's already in the affidavit" (Tr. 333–334). Counsel for the other parties agreed to this suggestion (*ibid.*). After comparing the two documents, the Trial Examiner observed that the memorandum did not "give Mr. Lubersky anything that he doesn't already have" in the affidavit. The Trial Examiner nonetheless stated he would give the memorandum to petitioners, but then reserved his ruling so that he could think about it overnight (Tr. 334–335). The Trial Examiner ob-

[9] *Jencks* v. *U.S.*, 353 U.S. 657.

served that only about 10 percent of the document—two purported quotes of Hahn—were producible; the rest were Mr. Stratton's opinions (Tr. 334–344).

The next day, June 15, the Trial Examiner ruled that he would not compel Henderson to produce the memorandum relying on the *Palermo* [10] and first *Campbell* [11] decisions (Tr. 348–350).

When Hahn's cross-examination was concluded, the next witness called was Richard Moore. On cross-examination by Lubersky, it was established that he had given one statement each to Labor and the Board (Tr. 398–399). Lubersky thereupon demanded that Henderson produce all statements, notes of statements, and summaries thereof which were in the possession of Labor and the Board (Tr. 400–401). Henderson gave Lubersky a copy of the statement Moore gave the Board, and said, "Other than that, * * * we do not have any copies of affidavits given by Moore to any other Government agency. * * *" There is one memorandum in the file which is a memorandum of a conversation made by Mr. Stratton * * *, but my position on that is the same as on the affidavit of Mr. Hahn (N. 401).[12]

Upon further interrogation by counsel for petitioners, Moore said that he had spoken to Board agents Henderson and Stratton before, and that he believed

[10] *Palermo* v. *U.S.*, 360 U.S. 343.

[11] *Campbell* v. *U.S.*, 365 U.S. 85.

[12] It is clear from the context that by the phrase, "affidavit of Mr. Hahn," Henderson really meant the Hahn memorandum. Petitioners do not contend that the Moore memorandum is producible.

that Henderson had taken notes of the conversation (Tr. 402–404). Lubersky demanded these notes, and Henderson denied having anything like that. He offered to make an explanation for the record, but counsel for petitioners, rather than accepting Henderson's offer to testify, moved that Moore's testimony be stricken because Moore had testified that notes had been taken and counsel for the General Counsel was "bound by" Moore's testimony that such notes did exist (Tr. 405–406). Upon examination by the Trial Examiner, Henderson specifically denied under oath that he took any notes when talking to Moore before the hearing, and explained how Moore might have become confused in that regard (Tr. 407–409). The parties then stipulated that the questions asked of Henderson regarding Davis' statements, and his answers thereto, would be the same regarding Moore (Tr. 411–413).[13] Petitioners' motion to strike Moore's testimony was denied.

Upon the conclusion of Moore's testimony on June 15, the hearings were recessed until July 10 (Tr. 519–521). The next day, June 16, petitioners finally sent a telegram to the Board asking that permission be granted to Henderson and Stratton to testify about the statements of Davis, Hahn and Moore (Tr. 531–532). On June 22, the General Counsel replied denying their request (Tr. 532–533).

On June 26, petitions to revoke the subpenas secured by petitioners on June 14 were filed by Henderson on

[13] Petitioners still had not applied to the General Counsel for permission for Henderson to testify.

behalf of the General Counsel, the Secretary of Labor, and the Attorney General (TX Exh. 2a, 2b and 2c). On July 12, the Trial Examiner granted the petitions and revoked the subpenas (Tr. 979–1004). Thereafter, on July 25, Henderson stated that the Board's files nowhere contain any statements, or copies thereof, which would be subject to production under the Board's rules other than those already made available to petitioners. He also assured petitioners that no statements had been destroyed or given back to another agency. When petitioners' counsel sought to ask more questions about the contents of the Board's files and the Board's investigation of the case, Henderson declined to answer pursuant to Section 102.118 of the Board's rules (Tr. 1015–1019).

III. The Board's conclusions and order

On the basis of the foregoing facts, the Board concluded, in agreement with the Trial Examiner, that by the employment of undercover operatives to engage in labor espionage and surveillance of union activities, petitioners thereby interfered with, restrained and coerced Harvey employees in the excise of their Section 7 rights in violation of Section 8(a)(1) of the Act (R. 131–132). In reaching this conclusion, the Board rejected petitioners' contention that the Wallace operatives were empoyed to detect only theft and the disposition of stolen goods, prostitution, dope peddling, gambling, and the unauthorized sale of liquor. The Board also rejected petitioners' claim that the Trial Examiner had erroneously refused to strike the testimony of General Counsel's

witnesses Davis, Hahn and Moore because petitioners were denied the witnesses' statements and related documents in the possession of the General Counsel and other federal agencies. The Board held that counsel for the General Counsel had given to petitioners copies of all the witnesses' statements in his possession, and that petitioners were not entitled to anything else upon demand as a matter of right (R. 129–130).

The Board's order required Harvey to cease and desist from the unfair labor practices found, and from in any other manner interfering with its employees' Section 7 rights. The Board ordered Wallace to cease and desist from engaging in union espionage for Harvey, or any other employer. Affirmatively, the Board's order requires petitioners to post appropriate notices (R. 131–132).

SUMMARY OF ARGUMENT

I

The Board properly asserted jurisdiction over General. On the basis of the facts found in earlier Board decisions, it is clear that Harvey and General constitute a single employer for the purposes of the Act. The Board could properly take official notice of those earlier decisions. Full opportunity was afforded to General to show a change in circumstances or to otherwise adduce new evidence, but General declined to do so. It cannot now complain, therefore, that the Board's action constituted prejudicial error.

II

Substantial evidence on the record considered as a whole supports the Board's finding that petitioners violated Section 8(a)(1) of the Act by engaging in labor espionage. This is so even if the testimony of Davis, Hahn and Moore be excluded. The credible testimony of Mr. and Mrs. Siemens as to the events leading up to the hiring of Wallace by Harvey, plus the inherently improbable testimony of Harvey's general manager, are sufficient by themselves to support the Board's findings of fact.

III

1. The Board produced for petitioners' inspection and use all statements of Davis, Hahn and Moore within its possession and control. The record clearly demonstrates that the Board never obtained statements from other federal agencies in the investigation or preparation of this case or that such statements had been used or seen. Counsel for the General Counsel never admitted having additional statements producible under *Jencks* or Section 102.118 of the Board's rules.

2. Petitioners received all the statements of witnesses to which they were entitled as a matter of right for impeachment purposes under Section 102.118. Petitioners were not entitled under *Jencks* to statements obtained by other federal agencies which the Board had never possessed, used or seen. Section

102.118 of the Board's rules, which defines the circumstances under which statements will be produced, is valid and proper. That rule, not the *Jencks* decision, is controlling in Board proceedings.

3. Section 11(1) of the Act does not deny to the Trial Examiner and the Board the power to revoke Board subpenas for any legally sufficient reason other than the two mentioned in the text of the Act. The Trial Examiner properly revoked the subpenas issued at the request of petitioners directed to the General Counsel, the Attorney General and the Secretary of Labor. Since petitioners could not obtain the material in question directly by demand under *Jencks,* they could not get it indirectly by means of subpena. In the absence of a showing of need independent of the alleged right to see if the material might be useful for impeachment purposes, the material subpenaed was privileged against disclosure.

4. The Board did not commit prejudicial error by declining to produce the Hahn memorandum for petitioners' inspection and use. The memorandum was not a "statement" as defined by the Board, Congress or the Supreme Court.

IV

Petitioners had no "right" to take the deposition of Lee Caldwell. It was within the Trial Examiner's discretion to permit or deny petitioners' request; his denial thereof did not constitute an abuse of discretion.

715-700—63——4

ARGUMENT

I. The Board properly asserted jurisdiction over General, having found that Harvey and General constitute a single employer within the meaning of the Act

There is no question before this Court of the Board's assertion of jurisdiction over Harvey and Wallace. As to General, the Board, in agreement with the Trial Examiner, found that General and Harvey constitute a single employer (R. 131, 135) and therefore, that General's operations—being Harvey's operations—affect commerce within the meaning of the Act (R. 135). We show below that the Board properly found that Harvey and General constitute a single employer and that General's contentions to the contrary, discussed in its separate brief, are without merit.

At the hearing, upon request of General Counsel, the Trial Examiner agreed to notice officially four prior reported Board cases holding that Harvey and General are a single employer under the Act (R. 135; Tr. 1405). These cases, all involving General and Harvey, are reported at 123 NLRB 586, 125 NLRB 674, 131 NLRB 648 and 131 NLRB 901. The Trial Examiner's action in taking official or judicial notice of the Board's own cases is in accordance with the Board's practice (see *Avco Manufacturing Corp.,* 107 NLRB 295; *Aabel Corp.,* 111 NLRB 180, 181) which this Court has held to be proper. *N.L.R.B.* v. *Townsend,* 185 F. 2d 378, 381 (C.A. 9), cert. denied, 341 U.S. 909. Accord: *N.L.R.B.* v. *Reed and Prince Mfg. Co.,* 205 F. 2d 131, 139–140 (C.A. 1) cert. denied, 346 U.S. 887; *Paramount Cap Mfg. Co.* v. *N.L.R.B.,* 206 F.

2d 109, 113–114 (C.A. 8); *N.L.R.B.* v. *Ozark Dam Constructors,* 203 F. 2d 139, 146–147 (C.A. 8).

In 123 NLRB 586, the Board found that General was organized by three attorneys at the request of Lawrence Harvey, executive vice president of Harvey. The day after its certificate of incorporation was filed, it commenced work for Harvey under a contract negotiated by the same Lawrence Harvey. The attorneys who formed General were its sole stockholders, officers and directors. One of the attorneys testified before the Board in that case that he was under a moral obligation to dispose of his stock in General pursuant to directions from "the Harvey interests." Moreover, the Board found in that case that Harvey employees reviewed General's accounting and purchasing functions and initial wage rates paid by General; that General's general manager and personnel manager were recommended for their jobs by Lawrence Harvey and that the personnel manager was a former Harvey employee who continued to perform services for Harvey; and that posted rules and schedules at General appeared on Harvey stationery. Finally, the Board found that, *inter alia,* Harvey owned the plant and the bulk of the equipment, co-signed payroll checks, reimbursed General for its costs, including labor costs, and had been General's sole source of income. On the basis of the foregoing, the Board found General and Harvey to be a single employer.

In 125 NLRB 674, the Board found that Harvey and General constituted a single employer relying on the evidence of common ownership and control ad-

duced in 123 NLRB 586, described immediately above, plus the additional evidence adduced in 125 NLRB that General was organized, as described above, for the purpose of erecting an aluminum plant in Oregon for Harvey with the understanding that when the plant was built it would be surrendered to Harvey for operation. Further, in the construction of the plant, a corps of Harvey's key employees were on the construction site to insure that the operations of General were in the best interest of Harvey.

In 131 NLRB 648, 656, the Board noted that the complaint therein alleged, and the answer of Harvey and General admitted, that both Harvey and General built the plant at The Dalles, Oregon and "both corporations are and have been 'at all material times' engaged in the business of * * * operating the plant; and in interstate commerce within the meaning of the Act." Moreover, in that case the Board found that the evidence established, beyond cavil, that the labor relations policies affecting General's production employees are prescribed and applied by Harvey's managerial representatives (131 NLRB 648, 657).

Finally, in 131 NLRB 901, 904 the Board took official notice of the jurisdictional facts in the earlier cases described above and therefore found it unnecessary to rely on the Trial Examiner's finding therein that Harvey and General acted in concert.

In view of the foregoing, General's complaint in its brief (p. 7) that it is impossible for General to determine just what facts, "if any," were noticed, does not merit serious consideration. It is perfectly clear

from the record that the Trial Examiner and the Board took official notice of the above-described cases involving General and Harvey as "to the finding with respect to commerce and the business entities involved and the nature of the business entities" (Tr. 1422).

Likewise devoid of merit is General's contention (pp. 6–8) that it was denied an opportunity to refute the jurisdictional facts officially noticed, or show that at the time of the events in question, Harvey and General were not a single employer. The record shows the contrary to be the case. As the Trial Examiner stated, "Counsel for * * * General repeatedly refused, when so requested, to make any contention or claims that there had been any change in the business relationship between * * * Harvey and * * * General subsequent to the prior holdings on the subject" (R. 135; Tr. 1405–1413, 1416–1418). General's allegation in its brief (pp. 3, 4, 7), that after the issuance of the Intermediate Report it moved the Board for leave to refute the jurisdictional data officially reported, is unsupported in the record. Footnote 6 in the Board's decision and order (R. 131), upon which General relies, refers to a motion by Harvey, *not* General, "to reopen the record so that it could present evidence in refutation of findings, *other than jurisdictional findings,* contained in prior Board decisions involving * * * Harvey on the ground that the Trial Examiner had based his decision thereon" (emphasis added).[14] Thus, while presented with

[14] That particular allegation of error is not raised by petitioners in the proceeding before the Court.

many opportunities to do so, General has never sought to present evidence to the Board to prove that at the time of the events in question, General and Harvey were not a single employer. Indeed, General could have disputed the propriety of the Board's finding of single-employer status when it petitioned this Court to review the Board's decision and order in 131 NLRB 648 (summarized *supra,* p. 22), yet it did not do so. See *General Engineering, Inc. and Harvey Aluminum (Incorporated)* v. *N.L.R.B.,* 311 F. 2d 570.[15]

In sum, the Board properly took official notice of jurisdictional facts in its prior cases involving the same parties, and these facts amply support the Board's assertion of jurisdiction over General in the instant case. Moreover, General was afforded numerous opportunities to rebut the matter officially noticed, if it so desired, but it voluntarily chose not to do so. Under these circumstances, General's claim that the Board's taking official notice of the earlier decisions deprived it of a fair hearing is patently lacking in merit.

II. Substantial evidence on the record considered as a whole supports the Board's finding that petitioners violated Section 8(a)(1) of the Act by engaging in labor espionage

It is an elementary proposition of law that the utilization of undercover operatives by an employer to spy on the union activities of his employees is a

[15] The Court there found, in agreement with the Board, that Harvey and General "jointly operate an aluminum plant" in The Dalles, Oregon. 311 F. 2d at 571.

violation of Section 8(a)(1) of the Act.[16] Petitioners admit that Wallace was engaged to spy on the Harvey employees at the plant in The Dalles and Torrance. They contend, however, that Wallace operatives were employed only to detect theft and other illegal conduct. On the basis of the Trial Examiner's credibility resolutions and in agreement with his findings, the Board rejected petitioners' version of the facts, and chose to believe instead the version as testified to by the witnesses presented by counsel for the General Counsel.

Summarizing and discussing the conflicting evidence and the factors involved in resolving the issues of credibility would serve no useful purpose. As the Board observed, "the Trial Examiner engaged in exhaustive analysis in resolving these conflicts * * *" (R. 131). His analysis is contained in the Intermediate Report, and rather than repeat or paraphrase it here, we respectfully refer the Court to that document itself. Suffice it to say at this point that, applying the established standard of review, the findings of fact of the Trial Examiner and the Board clearly are entitled to acceptance by the Court on the basis of the record presented.[17]

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[16] *N.L.R.B.* v. *Fansteel Metallurgical Corp.*, 306 U.S. 240; *Consolidated Edison Co.* v. *N.L.R.B.*, 305 U.S. 197, 230; *N.L.R.B.* v. *Fruehauf Trailer Co.*, 301 U.S. 49; *N.L.R.B.* v. *Friedman-Harry Marx Clothing Co.*, 301 U.S. 58, 75.

[17] See, *Universal Camera Corp.* v. *N.L.R.B.*, 340 U.S. 474; *N.L.R.B.* v. *Pittsburgh Steamship Co.*, 337 U.S. 656; *N.L.R.B.* v. *Walton Mfg. Co.*, 369 U.S. 404, 408; *N.L.R.B.* v. *U.S. Drivers Co.*, 308 F. 2d 899, 905 (C.A. 9), and cases cited therein; *N.L.R.B.* v. *Dinion Coil Co.*, 201 F. 2d 484 (C.A. 2); *Olson Rug Co.*, v. *N.L.R.B.*, 304 F. 2d 710, 715 (C.A. 7).

Apparently recognizing that there is no warrant for the Court to find credible those whom the Trial Examiner found to be incredible, and to disregard the testimony of those whom the Trial Examiner concluded merited belief, petitioners seek to prevail here by raising a number of alleged procedural errors committed by the Board which, they claim, prejudiced their case and entitles them to a judgment denying enforcement of the Board's order.

The principal contention of petitioners is that the Board's findings of fact rest on the testimony of three witnesses which should be stricken because petitioners were not given all the information and documents they were entitled to for purposes of their cross-examination. These witnesses, Calvin Davis, Stanley Hahn and Richard Moore, were Wallace operatives who testified regarding the nature and extent of their union espionage, and petitioners' involvement therein. In the following portion of this brief, we shall show that, contrary to their contentions, petitioners received all the documents which the Constitution, the Act, and the Board's own rules require that they be given in order properly to cross-examine Davis, Hahn and Moore. We show first, however, that even absent the testimony of these three witnesses, the Board's findings are supported by substantial evidence.

While the only direct evidence that Wallace operatives actually spied upon the Harvey employees' union activities is contained in the testimony of Davis, Hahn and Moore, the testimony presented by Wallace's sales

representative, Frank Siemens, his former wife, Mrs. Vernon Siemens, and Andrew Cronkrite, general manager of Harvey's plant at The Dalles, provide substantial independent suport for that finding. For it is established by the credited testimony of Mr. and Mrs. Siemens (summarized *supra,* pp. 3–4) that Wallace was hired by Cronkrite for the sole purpose of engaging in union espionage. The truth of the Siemens' testimony is confirmed by the inherent improbabilities in the testimony of General Manager Cronkrite, who testified that Wallace was retained only to uncover thefts and the disposition of stolen goods. For while the record establishes that thievery was rampant, Cronkrite admitted that no action was taken about the reports of thefts which were made (Tr. 2645–2651, 2724–2725). In his careful and detailed analysis of the testimony, the Trial Examiner pointed out that the various reasons assigned by Cronkrite for the employer's failure to act were plainly incredible (R. 164–171). Harvey was given names, dates and facts concerning the many thousands of dollars worth of equipment that were looted from the plant, and operative Stark several times offered to set up traps to catch the thieves in the act. Out of all this came one purported reprimand to a supervisor caught stealing, who thereafter engaged in at least two other reported thefts, but went unpunished (R. 168; Tr. 2650–2651). In short, the testimony of Cronkrite so defies belief as to justify the inference that the Wallace Detective Agency actually did what Mr. and Mrs. Siemens testified it was hired to do—i.e., spy on the

employees' union activities. Cf. *N.L.R.B.* v. *Dant & Russell,* 207 F. 2d 165, 167 (C.A. 9); *N.L.R.B.* v. *Griggs Equipment, Inc.,* 307 F. 2d 275, 278 (C.A. 5); *N.L.R.B.* v. *Bird Machine Co.,* 161 F. 2d 589, 592 (C.A. 1); *N.L.R.B.* v. *Brezner Tanning Co.,* 141 F. 2d 62, 64 (C.A. 1).

III. The Board did not commit prejudicial error in any of the procedural rulings of which petitioners complain

Even assuming *arguendo* that the Board's findings of fact can stand only if supported by the testimony of Davis, Hahn and Moore, we submit that those findings should be accepted by the Court because the Board properly denied petitioners' motions to strike the testimony in question. The motions to strike were based on the claim that they had not been supplied with all the documents they were entitled to as a matter of right for the purpose of seeing if there was anything contained therein which might be used to impeach the witnesses on cross-examination. As we shall now show, the arguments made by petitioners in support of their motions are totally lacking in merit.

A. The Board produced for petitioners' inspection and use all statements of the witnesses within its possession and control

Contrary to petitioners' charge that the Board has sought to "hide evidence" (Br., p. 57), the record shows that at the appropriate time during the hearing, counsel for the General Counsel turned over to petitioners upon their request copies of all statements in his possession or control. Petitioners' innuendo that counsel for the General Counsel was seeking to

deceive petitioners, the Trial Examiner, the Board and the Court by either destroying or returning statements taken by other agencies of the federal government to obstruct petitioners' access to them, is not only unsupported by the record, but is directly controverted by the sworn statements of Mr. Henderson in response to questions by both Mr. Lubersky and the Trial Examiner.

As shown in the Statement, *supra,* pp. 10–11–12, 16, Henderson stated under oath that petitioners had been given copies of all statements of the witnesses in the possession of the General Counsel, and that the General Counsel had never returned any statements to other agencies, or destroyed any statements obtained from other agencies (*supra,* pp. 10, 16). In other words, the General Counsel never had in his possession or control any statements given by Davis, Hahn and Moore other than the ones produced. Moreover, upon the direction of the Trial Examiner, Henderson searched his files for anything which might "approximate a statement" and came up with nothing except two file memos relating to conversations with Hahn and Moore (*supra,* pp. 11–12, 14). Both of these memos were given to the Trial Examiner so that he could determine whether they, or any part of them, constituted "statements" within the Supreme Court's definition of that term in *Campbell* v. *United States,* 365 U.S. 85. Henderson also took the stand and, over petitioners' objections, testified regarding notes which Moore testified he believed Henderson took during an oral interview (*supra,* pp.

14–15). This last incident is especially significant for two reasons: it is further evidence that Henderson and the Trial Examiner were not narrowly construing Section 102.118; and petitioners' attempt to prevent Henderson from testifying as to whether he had any notes of an interview with Moore shows that they were not really interested in obtaining this purported statement for possible impeachment purposes, but were more concerned with laying procedural traps so that they could subsequently claim that they were denied due process and thereby avoid an adverse determination regardless of the merits of the case against them. The demonstration of cooperation and fair play exhibited to petitioners by the Trial Examiner and counsel for the General Counsel, however, is a far cry from the bad faith and deceit with which petitioners seek to paint their actions.[18]

Petitioners also contend that Henderson admitted he had additional material subject to production upon demand when, in his petition to revoke the subpena

[18] Petitioners cannot seriously maintain that they were entitled to examine the General Counsel's files in order to confirm the truth of Henderson's testimony that everything which might be subject to production had been produced. The Supreme Court said in regard to the Jencks Act (18 U.S.C. 3500) that "the defense may [not] see statements in order to argue whether it should be allowed to see them" (*Palermo* v. *United States*, 360 U.S. 343, 354). That statement applies with equal logic here. "Surely the executive files of the Government are not to be invaded more easily and with less basis in a regulatory administrative proceeding of this sort than they would be in a criminal prosecution" (*Communist Party of U.S.* v. *S.A.C.B.*, 254 F. 2d 314, 325 (C.A.D.C.)).

duces tecum which had been served upon the General Counsel, he stated (Tr. Ex. Exh. 2–c):

> The documentary evidence required to be produced in response to the subpena is contained in regional office case files and other records within the control of the General Counsel. * * *

This argument assumes that everything sought by the subpena constituted "statements" within the meaning of the *Jencks* line of cases. However, the subpenas required the production of, *inter alia,* "notes, excerpts or summaries thereof and any summaries of other statements or other records of interviews and writings with respect to any such oral statements" of Davis, Hahn and Moore (Tr. Ex. Exh. 1–B). It is now well settled that unless they have been signed or otherwise adopted or approved by the witness, or are otherwise certain to constitute an accurate recital of what the witness said, such third-person notes, summaries, writings, etc., are not deemed "statements" and are not subject to production upon demand under *Jencks.* *Campbell* v. *United States,* 365 U.S. 85, 373 U.S. 487; *Palermo* v. *United States,* 360 U.S. 343, 349–351, 352–353, fn–11; *Ogden* v. *United States,* 303 F. 2d 724, 734–735 (C.A. 9); *United States* v. *Aviles,* 315 F. 2d 186, 191–192 (C.A. 2); *Communist Party of U.S.* v. *S.A.C.B.,* 254 F. 2d 314, 325 (C.A.D.C.). Thus, Henderson's representation in his petition to revoke that the evidence sought is under the control of the General Counsel could have referred merely to that material listed in the subpena which was not producible under *Jencks.* In view of Henderson's

sworn statements made both before and after the filing of the petition to revoke to the effect that everything even arguably subject to production had been produced, it is quite clear that that is all the petition referred to, and that it could not properly be construed to constitute an admission to the contrary.

Petitioners also contend that there was reasonable cause to believe that agents of the General Counsel had seen or been told the contents of the statements given by the witnesses to the other agencies, and therefore, the representatives of the General Counsel were duty bound to testify so that petitioners and the Trial Examiner could determine if that belief is correct. The only basis in the record for the contention that the statements had been made available to the General Counsel, however, is the unsupported accusation to that effect made by counsel for Harvey on June 14 while examining Henderson about the Board's files (*supra,* p. 11). Henderson's inability to respond to that accusation because of the prohibition imposed upon him by Section 102.118 of the Board's rules does not warrant an inference that the allegation has any basis in fact.[19] Unlike the situation in *N.L.R.B.* v. *Capitol Fish Co.,* 294 F. 2d 868, 870–871 (C.A. 5), counsel for Harvey neither adduced any testimony nor made an offer of proof to support his charge.

[19] In this connection, it is worthy of note that this charge was made by petitioners knowing that Henderson was barred from answering the loaded questions by Section 102.118. Lubersky had already plainly indicated that he was not interested in Henderson's answers, but that he just wanted to get his questions into the record (Tr. 119). Cf *N.L.R.B.* v. *General Armature & Mfg. Co.*, 192 F. 2d 316, 318 (C.A. 3), certiorari denied, 343 U.S. 957.

There was thus no showing of need (a requirement which petitioners in their brief, pp. 56–58, still accept as necessary), nor any other basis for finding that, as a matter of fundamental fairness to petitioners, Henderson's testimony on this point was required. Accordingly, the question of whether Henderson and Stratton could have or should have been compelled to testify despite the General Counsel's refusal to permit them to do so under Section 102.118 need not be considered.[20] Cf. *N.L.R.B.* v. *Vapor Blast Mfg. Co.,* 287 F. 2d 402, 407–408 (C.A. 7), cert. denied, 368 U.S. 823; *Raser Tanning Co.* v. *N.L.R.B.,* 276 F. 2d 80, 82 (C.A. 6), cert. denied, 363 U.S. 830; *N.L.R.B.* v. *Chambers Mfg. Corp.,* 278 F. 2d 715, 716 (C.A. 5); *N.L.R.B.* v. *Central Oklahoma Milk Producers Assn.,* 285 F. 2d 495, 498 (C.A. 10); *Biazevich* v. *Becker,* 161 F. Supp. 261, 265 (S.D. Cal.).

B. Under *Jencks*, petitioners do not have the right to obtain, for impeachment purposes, statements which have been made by the Board's witnesses to other federal agencies in connection with other statutes administered by them

In addition to the argument that the Board engaged in a willful scheme to have the benefit of the statements in the possession of other federal agencies while at the same time keeping them from petitioners, it is also contended that even if no employee or agent of

[20] Contrary to petitioners' assertion (Br. p. 44), the Board has never contended in this proceeding "that it need not account for or seek the return of documents transported to other agencies. . . ." The Board does contend that the record clearly negates any impression petitioners seek to create in their brief that the Board ever had producible documents which were transported to other agencies.

the Board possessed, saw, or made use of the statements given by the three Board witnesses to the Department of Labor or the FBI, petitioners had a right, by virtue of the Supreme Court's decision in *Jencks* v. *United States,*[21] to inspect them upon demand for possible impeachment purposes during cross-examination in the unfair labor practice proceedings (Br. p. 40–41). This contention, however, is equally without merit.

In *Jencks,* the Court "exercis[ed its] power, in the absence of statutory provision, to prescribe procedures for the administration of justice in the federal courts * * * [and] decided that the defense in a federal criminal prosecution was entitled, under certain circumstances, to obtain, for impeachment purposes, statements which had been made to government agents by government witnesses." *Palermo* v. *United States,* 360 U.S. 343, 345. The rule enunciated in *Jencks* was not a constitutional principle, and it was replaced as the controlling authority in criminal proceedings when Congress adopted the Jencks Act (71 Stat. 595, 18 U.S.C. Sec. 3500). *Palermo* v. *United States, supra,* 360 U.S. at 353–354, n. 11; cf. *Pittsburgh Plate Glass Co.* v. *United States,* 360 U.S. 395, 398–400.[22] The Second Circuit subsequently held, however, that the holding in *Jencks* applied to administrative proceedings as well, and the Board acqui-

[21] 353 U.S. 657.

[22] If any constitutional issues did underly the *Jencks* decision, they involved the Sixth, not the Fifth Amendment. *Palermo* v. *United States*, *supra*, 360 U.S. at 362–363 (concurring opinion).

esced in this determination. See *N.L.R.B.* v. *Adhesive Products Co.,* 258 F. 2d 403, 407–408; *Ra-Rich Mfg. Co.,* 121 NLRB 700. To implement this determination, the Board modified its rules prohibiting disclosure of the contents of its files in any judicial or administrative proceedings except upon the written consent of the Board or the General Counsel (29 C.F.R. Secs. 102.117(b), 102.118), and added the following proviso:

> After a witness called by the general counsel has testified in a hearing upon a complaint under section 10(c) of the act, the respondent may move for the production of any statement of such witness in possession of the general counsel, if such statement has been reduced to writing and signed or otherwise approved or adopted by the witness. Such motion shall be granted by the trial examiner. If the general counsel declines to furnish the statement, the testimony of the witness shall be stricken (Section 102.118).

Pointing to the fact that the proviso requires consent for the General Counsel to produce only those statements in *his* possession, petitioners contend that the regulation is unlawful since it is narrower than *Jencks,* which, they assert, applies to statements in the possession of any federal agency including those not involved or concerned with the particular criminal case. Even assuming *arguendo* that *Jencks* could reach as far as petitioners contend it does in criminal cases, their argument that the Board's rule should be as broad is frivolous on its face—the Board has absolutely no power to promulgate a regulation com-

pelling other federal agencies to open their files to the Board or to parties in litigation before the Board. In referring to statements "in possession of the general counsel," the Board went as far as it lawfully could go to effect compliance with *Jencks*.[23] Petitioners also contend that the proviso to Section 102.118 is unlawful because it narrows the scope of the term "statements" as used in *Jencks*. The fact is, however, that the Supreme Court nowhere defined "statements" in its decision, and while the Congressional definition in the Jencks Act is broader,[24] it cannot seriously be maintained that the Board is bound by a provision of the criminal code in proceedings which, under Section 10(c) of the Act, are governed "so far as practicable, * * * in accordance with the rules of evidence applicable in the district courts of

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[23] Indeed, the Board went even farther than did Congress in the Jencks Act, for the latter requires the Government to produce a statement only if it "was *made* * * * to an agent of the Government * * *" (18 U.S.C. Sec. 3500(a), emphasis added), whereas the Board's rule would apply regardless to whom the statement was made, just so long as it came into "*possession* of the general counsel" (emphasis added). Moreover, while both *Jencks* and the Jencks Act apply only to statements relating to the subject matter of the testimony, the Board's rule imposes no such restriction.

[24] In subsection (e) of 18 U.S.C. Sec. 3500, "statement" is defined as:

> (1) a written statement made by said witness and signed or otherwise adopted by him; or
>
> (2) a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a substantially verbatim recital of an oral statement made by said witness to an agent of the Government and recorded contemporaneously with the making of such oral statement.

the United States under the rules of civil procedure for the district courts * * *." The Board adapted the *Jencks* principle as best it could to the requirements of its proceedings; it need do no more.

Petitioners also contend that in any event, their right to the statements given to Labor and the FBI is not founded upon the Board's rules, but upon the fundamental grant of right contained in the *Jencks* decision itself, and that regardless of the Board's rules, if the witness's statements could not be obtained from the other Federal agencies, the witness's testimony should be stricken. As we have already shown, however, *Jencks* did not announce a constitutional due process requirement, but dealt only with a procedural matter in criminal trials. Hence, petitioners have no right under *Jencks* to statements made to other agencies in these Board proceedings because the Board's rule, not *Jencks,* controls. To hold that the Board must get the statements or lose the witnesses would leave the trial of Board cases at the mercy of the fortuitous coincidence of investigations conducted by this and other agencies—each concerned only with the administration of its own laws. Had the FBI or Department of Labor been aiding the Board in its investigation of the unfair labor practice charges, the Board would, of course, have been under a duty to produce the statements. But as we have shown, *supra,* p. 9, n. 4, such was not the case. As the Second Circuit said in *United States* v. *Grayson,* 166 F. 2d 863, 870, "* * * there is an obvious distinction between documents held by officials who are them-

selves charged with the administration of those laws for whose violation the accused has been indicted, and those which are not so held." Cf. *People* v. *Parham,* 384 P. 2d 1001, 1002–1003 (S. Ct., Cal.); *Commonwealth* v. *Smith,* 192 A. 2d 671, 672–673 (S. Ct., Pa.). See *St. Regis Paper Co.* v. *United States,* 368 U.S. 208, 217.

Nor were petitioners prejudiced by the Board's failure to request the FBI and Department of Labor to give the Board copies of their statements so that petitioners might inspect them for possible impeachment purposes on cross-examination. Petitioners had obtained subpenas *duces tecum* from the Trial Examiner directed to the Attorney General and Secretary of Labor on June 14, the first day of Davis' cross-examination; a request by the Board for the same material could have added nothing to the request embodied in the subpenas. Moreover, contrary to the assertion of petitioners in their brief, pp. 45–46, the Board's failure to ask the other agencies to give it copies of the statements is not inconsistent with its practice in other cases. In *Tomlinson of High Point, Inc.,* 74 NLRB 681, the Board asked the Secretary of Labor if he would comply with a subpena (if one were issued and served) and produce documents which would have been admissible to prove the truth of what was contained therein. Here, in contrast, the statements sought by petitioners could only have been used to show, perhaps, that the Board's witnesses were not credible because they had changed their stories. Cf. *N.L.R.B.* v. *Local 160, Hod Carriers,* 268 F. 2d 185, 186 (C.A. 7); *N.L.R.B.* v. *Quest-Shon Mark Brassiere*

Co., 185 F. 2d 285, 289 (C.A. 2), cert. denied, 342 U.S. 812. In *Carpenters Local Union #224, etc. (Peter Kiewit Sons Co.)*, 132 NLRB 295, the Board did not, as petitioners claim, reverse the Trial Examiner's finding of a violation on the ground that he had improperly credited a state employee who would not produce certain confidential state files for purposes of cross-examination. Rather, the Board affirmed the Trial Examiner's refusal to credit the contradicted testimony of a former state employee because the state documents which would have settled the issue were denied to the Trial Examiner by a state official as being confidential and privileged under state law. Again, the material which the other governmental agency refused to disclose would have been admissible to prove the truth of its contents, and did not constitute, as here, merely another possible means of attacking the credibility of the witness.

In sum, the Board produced for petitioners' inspection and use all statements of the witnesses to which petitioners were entitled as a matter of right under the Board's rules, and its failure to produce or seek the statements given to the FBI and Department of Labor did not constitute a denial of due process.

C. The Board did not commit prejudicial error in revoking the subpenas directed to the General Counsel, the Attorney General, and the Secretary of Labor

As shown in the statement, *supra,* pp. 10–11, when counsel for the General Counsel failed to satisfy petitioners' demand that he give them all the documents they contended they were entitled to under their interpretation of *Jencks,* petitioners sought to accomplish the same objective by obtaining from the Trial Ex-

aminer subpenas *duces tecum* for those documents and directed at the General Counsel, the Attorney General, and the Secretary of Labor. On the petitions of the three officials, the Trial Examiner subsequently revoked the subpenas. We submit, contrary to petitioners, that the Trial Examiner had the power to revoke the subpenas and that he properly did so.

Section 11(1) of the Act provides: "The Board, or any member thereof, shall upon application of any party * * * forthwith issue to such party subpenas requiring * * * the production of any evidence * * *. Within five days after the service of a subpena on any person requiring the production of any evidence in his possession or under his control, such person may petition the Board to revoke, and the Board shall revoke, such subpena if in its opinion the evidence whose production is required does not relate to * * * any matter in question in such proceedings, or if in its opinion such subpena does not describe with sufficient particularity the evidence whose production is required." The Board's rule implementing this provision of the Act provides, *inter alia,* that "the trial examiner or the Board, as the case may be, shall revoke the subpena if in its opinion the evidence whose production is required does not relate to any matter under investigation or in question in the proceedings or the subpena does not describe with sufficient particularity the evidence whose production is required, or if for any other reason sufficient in law the subpena is otherwise invalid" (29 C.F.R. Sec. 102.31(b)).

Relying on *N.L.R.B.* v. *Cashman Auto Co.*, 223 F. 2d 832 (C.A. 1), petitioners contend that the Trial Examiner could revoke the subpenas only if they came within the two conditions set forth in the text of the Act, i.e., if the evidence sought is irrelevant to the matter involved, or if the subpena "does not describe with sufficient particularity the evidence whose production is required." But if petitioners actually accept *Cashman Auto* as controlling, then they are barred from complaining to this Court about the Board's failure to enforce the subpenas, for the court there went on to hold that since the Trial Examiner was without power to revoke the subpena for the reasons asserted, the revocation was a nullity and the respondent, on whose behalf the subpena was issued, should have asked the General Counsel to institute enforcement proceedings under Section 11(2) in the appropriate district court. Its failure to make such a request at the appropriate time precluded it from complaining later that the failure to enforce was prejudicial. In the case at bar, the record is barren of any request by petitioners that the General Counsel seek judicial enforcement of the subpenas.[25]

While petitioners' failure to act would be fatal to their position under *Cashman Auto,* we do not rely on that as a basis for rejecting petitioners' claim, because we believe that, with all due respect to the

[25] In their brief, p. 68, n. 72, petitioners seek to distinguish that case from this on the ground that in *Cashman Auto*, no petition to revoke had been filed by the party subpenaed. That distinction is of no consequence, however, because the First Circuit did not decide the case on that basis.

First Circuit, it erred in holding that the Trial Examiner was without power to revoke subpenas for reasons other than the two enumerated in Section 11(1). While there is no legislative history on the point, we submit that the two grounds for revocation set forth in Section 11(1) were meant to be illustrative only, and that Congress could not have intended to deprive the Board, as the issuing authority, power to revoke subpenas for any other reason equally sufficient in law. To hold otherwise would impose an impossible burden on the federal courts, for it would mean that only the courts could pass upon petitions to revoke based upon the allegation that production as demanded in the subpena would be burdensome and oppressive; or because the party subpenaed did not have the evidence described; or because the subpena was not properly served; or for any number of similar reasons which the Board, the Regional Directors and the Trial Examiners are faced with daily in literally scores of representation and unfair labor cases. Under the scheme of the Act, Congress clearly intended that such interlocutory rulings as the revocation of subpenas for any reason be handled by the Board alone, subject to review for prejudicial error in the courts of appeals under Section 10 (e) and (f) of the Act, *N.L.R.B.* v. *Steel, Metals, Alloys, etc., Local 810, Teamsters,* 253 F. 2d 832 (C.A. 2); *N.L.R.B.* v. *Blackstone Mfg. Co.,* 123 F. 2d 633 (C.A. 2); *N.L.R.B.* v. *Vapor Blast Mfg. Co.,* 287 F. 2d 402; 407–408 (C.A. 7), cert denied, 368 U.S. 823; *N.L.R.B.* v. *Thayer,* 213

F. 2d 748, 757–759 (C.A. 1), cert. denied, 348 U.S. 883; *N.L.R.B.* v. *Jamestown Sterling,* 211 F. 2d 725, 726 (C.A. 2); *N.L.R.B.* v. *Quest-Shon Mark Brassiere Co.,* 185 F. 2d 285 (C.A. 2), cert. denied, 342 U.S. 812; *New Britain Machine Co.,* 105 NLRB 646, n. 2, enforced, 210 F. 2d 61 (C.A. 2).

Having thus shown that the Trial Examiner had the power to revoke the subpenas issued in this case for any legally sufficient reason, we turn now to the issue of whether the revocations were proper. It is axiomatic that a subpena *duces tecum* is not in itself a grant of right to the production of documents, but is merely a means to obtain material to which the party causing the subpena to be issued is otherwise entitled. In the instant proceeding, petitioners base their claim of right on *Jencks,* contending they are entitled to see any document relating to any statement made by the witness to any government agency bearing on the subject matter of his testimony, because of the possibility that there might be something contained therein which might be inconsistent with what he has testified to on direct examination, thereby providing an opportunity to attack his credibility. If *Jencks* does apply, however, then the subpenas are not necessary, for the *Jencks* rule has its own built-in mechanism of compulsion—if the documents are not produced, the testimony of the witness shall be stricken. But as we have already shown, *Jencks* does not apply to Board proceedings except insofar as its precept has been incorporated in the proviso to Section 102.118. Therefore, if the Board

has properly limited discovery in this respect to defined statements in its possession, petitioners cannot circumvent this restriction by the service of subpenas *duces tecum.*

The propriety of the Trial Examiner's order of revocation is further supported by the fact that all three agencies—the Board, the Department of Justice and the Department of Labor—have regulations prohibiting the disclosure of the contents of their files except with the permission of the agency. 29 C.F.R. Sections 2.9, 102.117(b) and 102.118; Attorney General Order No. 3229, 18 Fed. Reg. 1368 (1953). It is settled law that these regulations are valid exercises of the executive power (*Touhy* v. *Ragen,* 340 U.S. 462; *Boske* v. *Comingore,* 177 U.S. 459), at least insofar as they place upon the party seeking the material the burden of demonstrating the need therefor so that the court can strike a balance between the conflicting claims. *United States* v. *Reynolds,* 345 U.S. 1; *Machin v. Zuckert,* 316 F. 2d 336 (C.A.D.C.); *Starr* v. *Commissioner of Internal Revenue,* 226 F. 2d 721, 723–724 (C.A. 7); *Madden* v. *Hod Carriers, etc., Local No. 41,* 277 F. 2d 688 (C.A. 7), cert. denied, 364 U.S. 863; *Kaiser Aluminum Co.* v. *United States,* 157 F. Supp. 939, 942 (Ct. Cl.). Cf. Rule 34, Federal Rules of Civil Procedure. Petitioners have made no such showing here, except to claim that they are entitled to the material as a matter of right. But where, as here, *Jencks* does not apply, such a claim is not enough; there must be a "showing of 'good

cause' * * *'' *N.L.R.B.* v. *Jamestown Sterling Corp.*, 211 F. 2d 725, 726 (C.A. 2), and cases cited therein.[25a]

Petitioners cannot successfully claim that they were hampered in their cross-examination of Davis, Hahn and Moore by the Trial Examiner's ruling; they had the affidavits the witnesses had given to petitioners as well as the Board, and the record is replete with petitioners' many allegedly successful attempts to destroy the witnesses' credibility. Hence, even if the Trial Examiner committed some error in disposing of the petitions to revoke, it was harmless.

D. The Board did not commit prejudicial error by refusing to produce the Hahn memorandum for petitioners' inspection

At the hearing, after petitioners had been given a copy of the statement given by Hahn to Board agent Stratton for purposes of cross-examination, petitioners also demanded that they be given a "memorandum to file" made by Stratton of a conversation he had with Hahn, but which Hahn had never seen. While counsel for the General Counsel, relying on Section 102.118 of the Board's rules, refused to permit petitioners to see it, he did show the memorandum to the Trial Examiner *in camera* so that the latter

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[25a] *United States* v. *Grayson*, 166 F. 2d 863 (C.A. 2); and *Bank Line* v. *United States*, 76 F. Supp. 801 (S.D. N.Y.), relied on by petitioners in their brief, are not to the contrary. Neither case involved an attempt to get a witness's statement because it might contain contradictions to his testimony, which is the sole basis asserted by petitioners here. In both cases, the party seeking the material had made a preliminary showing that the material was necessary because it contained evidence bearing directly on the merits of the case.

could rule on whether it was producible. Upon examination of the document, the Trial Examiner described it as being less than a page in length, and containing Stratton's comments and impressions of the conversation along with "purported quotes of what the witness said * * * specifically two two-word phrases" comprising not more than 10 percent of the memorandum (Tr. 333, 351). Pursuant to petitioners' suggestion, the Trial Examiner compared the memorandum with Hahn's affidavit which had already been given petitioners for the purpose of determining whether it added to or differed with the adffidavit in any way. After comparison, the Trial Examiner noted that in his opinion, Stratton's notes would not give petitioners anything they did not have already in the affidavit. Accordingly, the Trial Examiner ruled that the document was not producible under the proviso to Section 102.118, stating that there was not "an iota of evidence that the statement Mr. Stratton wrote for file was anything other than impressions" (Tr. 352–353).

Relying on *Campbell* v. *United States,* 373 U.S. 487, petitioners contend that they were "entitled to see at least part and perhaps all of the document to assist them in cross-examining the witness" (Br. p. 78). Nothing in *Campbell,* however, supports petitioners' claim, for there it was shown that the document in question was an "Interview Report" of what the witness had told an FBI agent, based upon notes which the agent had read back to the witness and which the witness had approved. The district court

had found "that the Interview Report recorded [the witness's] statement 'almost *in ipsissima verba.*'" 373 U.S. at 495, n. 10. Here, on the other hand, the memorandum consisted almost entirely of the Board agent's comments and impressions, with only two purported quotes of the witness. The two situations, therefore, are hardly comparable. Cf. *Palermo* v. *United States,* 360 U.S. 343, 352–353. The memorandum involved here is obviously the type of inter-office communication which is unquestionably privileged against disclosure. *Appeal of SEC,* 226 F. 2d 501 (C.A. 6).

Moreover, even if all but "two, two-word quotes" should have been cut out of the document so that it could be given to petitioners, the Trial Examiner's failure to do so does not constitute prejudicial error, for he found that the memorandum added nothing to what was contained in the affidavit which was given to them. *Rosenberg* v. *United States,* 360 U.S. 367, 370–371; *Ogden* v. *United States,* 303 F. 2d 724, 739–741 (C.A. 9).

IV. The Board properly denied petitioners' application for the deposition of Lee Caldwell

Petitioners' contention (Br. 78–81) that the Trial Examiner erred in denying their application for the deposition of Lee Caldwell during an approaching recess is plainly without merit. This Court has flatly stated that "There is no provision in the Act authorizing the use of the discovery procedure." *N.L.R.B.* v. *Globe Wireless,* 193 F. 2d 748, 751 (C.A. 9). Even assuming *arguendo* the existence of such rights, the

denial here was a proper exercise of the Trial Examiner's discretion.[26]

Discovery not being a central part in administrative hearings as it is in federal courts, the Trial Examiner found no reason to depart from the usual procedure of allowing cross-examinations only. In essence, the only "good cause" shown by petitioners for requesting the extraordinary privilege of taking a deposition in a case such as this was that the testimony of the Board's witnesses was "sharply disputed" (Br. 80) by petitioners' witnesses. We submit that this is not an uncommon situation in any litigation. Moreover, petitioners' characterization of the Board's witness as "perjurers and alcoholics" (Br. p. 80) implies only that Caldwell's testimony after the recess would be different from what it would be if there were no recess—an implication, we submit, not worthy of reply.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that substantial evidence supports the Board's findings, and that the Board did not commit errors which prejudiced petitioners' right to a fair hearing. Accordingly, a decree should be entered enforcing

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[26] Section 102.30 of the Board's Rules and Regulations provide in relevant part that "Witnesses shall be examined orally under oath, except that for good cause shown after the issuance of a complaint, testimony may be taken by deposition. (a) The * * * Trial Examiner * * * shall * * * if in his discretion good cause has been shown, make and serve upon the parties an order which will specify the name of the witness where deposition is to be taken * * *."

the Board's order in full. If the Court should be of the opinion, however, that it was prejudicial error to refuse to allow petitioners to inspect, for purposes of cross-examination, some of the documents denied them, we urge that the Court remand the case to the Board for further action consistent with its decision, and not, as petitioners demand, simply deny enforcement and terminate the case. Petitioners recognize (Br. p. 109–110) that the appropriate course would be to remand the case to the Board, but contend that the penalty of dismissal announced by the Supreme Court in *Jencks* should apply, because "the Government's conduct was willful and deliberately designed to deny petitioners their rights" (Br. p. 110). Contrary to petitioners' claim, however, the record shows that the Board made every effort to accord petitioners every right to which all parties appearing before it are entitled. If the Board erroneously denied them some documents to which they were entitled, it did not do so maliciously, and the Board should not be treated as if it had. If error was committed here, it was no more willful than in the many cases following *Jencks,* which have been remanded by the appellate courts so that the trial courts could correct whatever errors had been found. We respectfully submit that, if necessary, the same course should be taken here. Petitioners' conduct as found by the Board in this and other cases in which petitioners have been involved, "discloses a clear cut purpose

to thwart the most basic guarantees of Section 7 of the Act" (R. 210). It should not go unremedied.

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DECEMBER 1963.

CERTIFICATE

The undersigned certifies that he has examined the provisions of rules 18 and 19 of this court and in his opinion the tendered brief conforms to all requirements.

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APPENDIX

I

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*), are as follows:

RIGHTS OF EMPLOYEES

SEC. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3).

UNFAIR LABOR PRACTICES

SEC. 8. (a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

* * * * *

PREVENTION OF UNFAIR LABOR PRACTICES

SEC. 10 * * * (b) Whenever it is charged that any person has engaged in or is engaging in any such unfair labor practice, the Board, * * * shall have power to issue and cause to be served upon such person a complaint stating

the charges in that respect, and containing a notice of hearing before the Board * * *, or before a designated agent or agency, at a place therein fixed, not less than five days after the serving of said complaint * * *. Any such proceeding shall, so far as practicable, be conducted in accordance with the rules of evidence applicable in the district courts of the United States, adopted by the Supreme Court of the United States pursuant to the Act of June 19, 1934 (U.S.C., title 28, secs. 723–B, 723–C).

* * * * *

II

The relevant provisions of the Board's Rules and Regulations Series 8, as amended (29 C.F.R., Subtitle B, Chapter I), are as follows:

Sec. 102.117 *Files, records, etc., in exclusive custody of Board and not subject to inspection; formal documents and final opinions and orders subject to inspection.* * * * (b) * * * Subject to the provisions of sections 102.31 and 102.66, all files, documents, reports, memoranda, and records pertaining to the internal management of the Board or to the investigation or disposition of charges or petitions during the nonpublic investigative stages of proceedings and before the institution of formal proceedings, and all matters of evidence obtained by the Board or any of its agents in the course of investigation, which have not been offered in evidence at a hearing before a trial examiner or hearing officer or have not been made part of an official record by stipulation, whether in the regional offices of the Board or in its principal office in the District of Columbia, are for good cause found by the Board held confidential and are not matters of official record or available to public inspection, unless permitted by the Board, its chairman, the general counsel, or any regional director.

III

The relevant provisions of the rules and regulations of the Department of Labor (29 C.F.R., Subtitle A), are as follows:

> Sec. 2.9 **Withdrawal of originals and copies from Departmental Records.** (a) *Originals.* No account, letter, record, file, or other document or paper in the custody of the Department, or of any bureau, office or officer thereof, shall on any occasion be taken or withdrawn by any agent, attorney, or other person not officially connected with the Department; no exception will be made without the written consent of the Secretary or his duly auhorized representative.
>
> (b) *Copies.* Copies of accounts, letters, records, files and other documents or papers shall not be furnished to any person except with the written consent of the Secretary or his duly authorized representative. Such written consent will be granted only to such persons as may have a personal material interest in the subject matter of the papers or at their request. Applications for copies of documents, accounts, records or files should be made to the Secretary and should be accompanied by an affidavit setting forth the interest of the applicant and showing the reason why and the purpose for which the copies are desired. Except where requests are made by the Attorney General under section 188 of the Revised Statutes (5 U.S.C. 91, 1952 ed.) for evidence touching the claims of persons suing the United States in the Court of Claims, copies of accounts, letters, documents, records, or other papers desired by or on behalf of parties to causes pending in any court shall be furnished only to the court on an order or a rule of the court requesting the Secretary to furnish the same, and then only when the production of such copies will not, in the judgment of the Secretary or his duly

authorized representative, be prejudicial to the Government or the public interest. No exception will be made without the written consent of the Secretary or his duly authorized representative.

U.S. GOVERNMENT PRINTING OFFICE: 1965

No. 18273

In The United States Court of Appeals for the Ninth Circuit

HARVEY ALUMINUM (INCORPORATED),
GENERAL ENGINEERING, INC., AND
WALLACE A. UMMEL D/B/A WALLACE
DETECTIVE AND SECURITY AGENCY,

PETITIONERS,

VS.

NATIONAL LABOR RELATIONS BOARD,

RESPONDENT.

ON PETITION TO REVIEW NATIONAL LABOR RELATIONS BOARD ORDER

REPLY BRIEF FOR PETITIONER GENERAL ENGINEERING, INC.

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INDEX

TABLE OF CASES

STATUTES

In the United States Court of Appeals
for the Ninth Circuit

No. 18273

HARVEY ALUMINUM (INCORPORATED),
GENERAL ENGINEERING, INC., AND
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DETECTIVE AND SECURITY AGENCY, PETITIONERS

VS.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

ON PETITION TO REVIEW NATIONAL LABOR RELATIONS BOARD ORDER

REPLY BRIEF FOR PETITIONER GENERAL ENGINEERING, INC.

SUMMARY OF ARGUMENT

Some cases have held that the Board may take official notice of facts found in prior decisions for the limited purpose of showing intent or state of mind. *NLRB v. Reed and Prince Mfg. Co.*, 205 F.2d 131 (1st Cir. 1953), *cert. denied*, 346 U.S. 887; 74 Sup. Ct. 139 (1953); *Paramount Cap Mfg. Co. v. NLRB*, 260 F.2d 109 (8th Cir. 1958). The Board may not notice such decisions for the purpose of establishing its jurisdiction.

Even in those cases where the courts have permitted the

Board to notice prior decisions as showing intent, the courts have held that the taking of notice does not shift the burden of proof. In the instant case both the trial examiner and the Board erroneously held that the taking of notice shifted the burden of proof to petitioners, Harvey Aluminum (Incorporated) and General Engineering, Inc.

The case of *NLRB v. Townsend*, 185 F.2d 378 (9th Cir. 1950), *cert. denied* 341 U.S. 909; 71 Sup. Ct. 621 (1951), cited in the respondent's brief, stands for the proposition that the failure to make timely objection before the Board to the taking of official notice of prior Board decisions precludes judicial review of the propriety of that practice. In the instant case the petitioners herein have objected at every stage of this proceeding.

Parties are not precluded from obtaining judicial review of issues by the failure to seek judicial review of similar issues in earlier proceedings. It is enough that the objection urged in this court in this proceeding was urged before the Board. There is nothing in the record in the instant case to support the Board's assumption of jurisdiction. It is submitted that this case as it relates to General Engineering, Inc. should be dismissed.

I Prior Board decisions are not admissible as evidence to support the Board's assumption of jurisdiction.

The Board relies upon four cases from the courts of appeal as holding proper the Board's practice of taking official notice of its prior decisions (Resp. Br. p. 20). Of the four, two hold that official notice may be taken of prior decisions for certain limited purposes. In *NLRB v. Reed and Prince Mfg. Co.*, 205 F.2d 131 (1st Cir. 1953), *cert. denied*, 346 U.S. 887; 74 Sup. Ct. 139 (1953), the issue was whether the employer had bargained in good faith with the union. The court held that the Board could consider past acts of the employer for the purpose of determining the employer's intent. In *Paramount Cap Mfg. Co. v. NLRB*, 260 F.2d 109 (8th Cir. 1958), the Board in an unfair labor practice case admitted evidence of statements hostile to the union attributed to the employer in a prior Board decision in an election

case. The court held that the statements were admissible for the purpose of establishing the employer's state of mind.[1] While some cases hold the Board may notice facts found in prior decisions as establishing an employer's intent or state of mind, it may not rely upon such decisions to establish its jurisdiction where a party objects to their being received.

Even assuming *arguendo* that such decisions could be noticed, the burden of proof does not shift to the employer. In the *Paramount Cap Mfg. Co.* case, *id.*, the court held that the evidence presented by means of official notice did not shift the burden of proof.[2] In the instant case, after taking official notice, the trial examiner placed upon General Engineering, Inc. and Harvey Aluminum (Incorporated) the burden of showing the noticed conclusions to be incorrect (Tr. 1421).

In *NLRB v. Brown & Root Inc.*,[3] 203 F.2d 139 (8th Cir. 1953) the court considered whether a previous determination that two employers were not to be treated as a single employer was res judicata in a subsequent proceeding. The court determined that it was not necessary to decide this question since the record before the court was inadequate to sustain the Board's decision that the two employers should be treated as a single employer.[4]

II Matters urged before the Board may be raised on review.

The Board relies upon *NLRB v. Townsend*, 185 F.2d 378 (9th Cir. 1950), *cert. denied* 341 U.S. 909; 71 Sup. Ct. 621

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[1] 260 F.2d at 112.

[2] The court declared:

"Hostility toward the union was not in itself an unfair labor practice and a presumption that such a state of mind once proven was presumed to continue did not shift the burden of proving the unfair labor practice * * *." 260 F.2d at 112.

[3] This case is cited in the Board Brief as *NLRB v. Ozark Dam Constructors*. Its title in the Federal Reports is as shown above.

[4] The court declared:

"But if the issue was not *res judicata* in the strict sense, we are still of the opinion that *there is an inadequate basis in the record* for visiting the sins of Ozark upon Flippen * * *." (Emphasis added.) 203 F.2d at 146.

(1951) as a decision of this court sustaining its position. In that case the Board took official notice of a prior decision that the company from whom the respondent purchased new cars received a large portion of its cars from another state. The court held that since the respondent had failed to object, either at the hearing or in exceptions filed with the Board, to the taking of official notice he was precluded from raising the issue on review.[5] In the instant case the petitioners objected at the hearing to the taking of official notice (Tr. 1420-1423). They sought to obtain a statement as to what "facts" were to be noticed or otherwise relied upon (Tr. 1422). None were specified. They called to the trial examiner's attention the fact that appeals were pending in this court in two of the cases (Tr. 1423). This petitioner filed with the Board exceptions to the reliance upon official notice by the trial examiner in his intermediate report and to the "findings" based upon official notice (R. 45-48, Exceptions 4-8,10-14). Petitioner Harvey moved the Board to reopen the proceeding to present evidence refuting the findings contained in the prior Board decisions (R. 41).[6] The Board denied the motion to reopen on two grounds. The first was that the trial examiner's use of official notice was proper. The second was that the trial examiner's decision was supported by the record in the instant case and that for that reason Harvey and General were not

[5] The court declared that the failure to object to the "receipt in evidence of the prior decision by the *questionable procedure of taking judicial notice* or to the finding of the basic fact rested thereon * * * precluded judicial review. (Emphasis added.) 185 F.2d at 380.

[6] In the opening brief for General Engineering, Inc. General was incorrectly referred to as the party moving to reopen the record. However, there is no question but that General is a "person aggrieved" by the Board's order denying the motion to reopen. 61 Stat. 149, 29 USC 160(f). Had Harvey been successful in refuting the noticed matter Harvey and General could not have been held to be a single employer.

Cf. Sec. 10(a) of the Administrative Procedure Act. Sec. 10(a) provides for judicial review by any person adversely "affected or aggrieved by any agency action." 60 Stat. 237, 5 USC 1009(a). Under Sec. 2(b) of the APA "person" includes organizations of any character other than agencies. 60 Stat. 237, 5 USC 1001(b). Agency action includes "the whole or part of every agency order * * * or denial thereof, or failure to act." 60 Stat. 237, 5 USC 1001(g).

harmed by the taking of official notice (R. 131). The Board's brief makes no reference to any fact in the record of the instant case tending to support the Board's conclusion. It is submitted that there is none.

The Board's brief does make extensive references to statements regarding Harvey Aluminum (Incorporated) and General Engineering, Inc. contained in prior Board decisions (Resp. Br. 21-23). Apparently it is now the Board's position that these are the facts which were noticed. At no point in the trial examiner's intermediate report nor in the Board's decision is there any reference to the evidential facts relied upon. This failure prevents the parties from knowing and meeting the information considered by the Board. Nor can this court determine what evidential facts, if any, the Board relied upon in making its decision.

The Board's brief refers to the failure of General Engineering to raise the issue of the identity of the parties in *General Engineering, Inc. v. NLRB*, 311 F.2d 570 (9th Cir. 1962), (Resp. Br. p. 24). The Board does not contend that that decision renders the question res judicata in this proceeding.[7] Rather, it seems to be the Board's position that the failure to seek review on an issue precludes the review of similar issues in all subsequent cases. It is submitted that it is enough that an objection has been urged before the Board. 61 Stat. 148, 29 USC 160(e).[8] The objection urged here has been raised at every step in this proceeding.

It is submitted that the Board improperly relied upon official notice as establishing its jurisdiction of General Engineering. The Board's decision is unsupported by the record.

CONCLUSION

For the reasons stated it is respectfully submitted that the

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[7] Section III.C. of this petitioner's opening brief is devoted to the question of whether the prior decisions as to the identity of General and Harvey render that issue res judicata in this proceeding (Gen. Engr. Br., p. 12-13).

[8] Section 10(e) of the Act provides in material part:

"No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court * * *." 61 Stat. 148, 29 USC 160(e).

Board's order as it relates to General Engineering, Inc. should be reversed and the case dismissed.

RHOTEN, RHOTEN & SPEERSTRA

By: WILLIAM B. WYLLIE

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General Engineering, Inc.

January 1964

CERTIFICATE

I certify that in connection with the preparation of this reply brief I have examined Rules 18 and 19 of this court and that in my opinion the foregoing reply brief is in full compliance with those rules.

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No. 18273

In the

United States Court of Appeals

For the Ninth Circuit

HARVEY ALUMINUM (INCORPORATED), GENERAL ENGINEERING, INC., and WALLACE A. UMMEL d/b/a WALLACE DETECTIVE AND SECURITY AGENCY,
Petitioners,

v.

NATIONAL LABOR RELATIONS BOARD,
Respondent,

NATIONAL LABOR RELATIONS BOARD,
Cross Petitioner.

REPLY BRIEF OF PETITIONERS HARVEY ALUMINUM (INCORPORATED) AND WALLACE A. UMMEL

Petition to Review Decision and Order of the National Labor Relations Board and Cross Petition to Enforce

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DAILY JOURNAL OF COMMERCE

SUBJECT INDEX

TABLE OF AUTHORITIES

CASES

OTHER AUTHORITIES

No. 18273

In the

United States Court of Appeals

For the Ninth Circuit

HARVEY ALUMINUM (INCORPORATED), GENERAL ENGINEERING, INC., and WALLACE A. UMMEL d/b/a WALLACE DETECTIVE AND SECURITY AGENCY,
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NATIONAL LABOR RELATIONS BOARD,
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NATIONAL LABOR RELATIONS BOARD,
Cross Petitioner.

Petition to Review Decision and Order of the National Labor Relations Board and Cross Petition to Enforce

REPLY BRIEF OF PETITIONERS HARVEY ALUMINUM (INCORPORATED) AND WALLACE A. UMMEL

I.

The Board concedes that Davis, Hahn and Moore gave statements respecting the subject matter of their direct testimony to the FBI and the Department of Labor (Bd Br 9, 12, 14) and that these witnesses provided *all* of the direct evidence supporting the charges (Bd Br 26-27). It asserts only that the record shows that General Counsel never had, never saw and never used the statements or copies or excerpts from them (Bd Br 10, 18, 29, 32, 33, n 20). This factual contention is so manifestly unsupported by the record as to reflect little credit on the Board.

The Board relies upon Mr. Henderson's examination on June 14, 1961 of his own trial file (Tr 136-148, see also Tr 404-406; Bd Br 11-12, 28-29) and the official statement of General Counsel issued six weeks later on July 25 (Tr 1016; Bd Br 16). It assumes that whenever Mr. Henderson stated that "we" did or did not do something, he spoke for General Counsel and his entire organization (Tr 116, 118-119, 331; Bd Br 10).

Possession of the Statements

In actual fact, Mr. Henderson limited his statements to the contents of his own files (Tr 137-138), and he expressly and repeatedly disclaimed knowing what other representatives of General Counsel might have in theirs (Tr 128, 992, 1017, see Tr 995). When he searched his own file, he refused even to state whether it contained any notes of the witness statements, and the Trial Examiner excluded such notes from his request (Tr 142, 147). There is no evidence that Mr. Henderson ever examined any other files of General Counsel or requested that they be examined by anyone else.

Further, both his statement and that of General Counsel were limited to documents deemed by them to be subject to production under Reg § 102.118 (Tr 128-129, 138, 142-143, 148, 1016), and no cross examination was permitted or additional information furnished which would allow their judgments to be tested. This was a critical qualification, for the Examiner (Tr 998) and the Board (R 130) both held that statements given to the other agencies, whether or not in General Counsel's possession and regardless of their form, are not

subject to production under the regulation.[1] Petitioners therefore could not and did not "accept" Mr. Henderson's representation that he had produced "everything" from his own file (Bd Br 12).

Use of the Statements

No one, including Mr. Henderson, ever denied that General Counsel had access to and use of these critical witness statements in preparing his case, and the Board's repeated assertions to the contrary are entirely unsupported by the record.

The matter arose twice during the hearing. When Mr. Henderson was examined by petitioners' counsel on June 14, 1961 he refused to state whether the statements had been used in preparing the Government's case (Tr 124-125); whether he had copies or notes of them (Tr 120-121, 122-124); whether he had seen them (Tr 123); whether he had discussed them (Tr 123-124); or whether he had had access to them (Tr 126).[2]

The second occasion was when General Counsel's official statement was read into the record on July 25, 1961:

> "* * * the Washington office has no copies of any statements which would be subject to production under the regulations of the Board, in addition

1. The Board on this appeal has apparently abandoned that position (Bd Br 36, n 23), which was, however, the basis of the rulings below.

2. The Board misrepresents both the record and petitioners' position (Bd Br 10, n 6). Mr. Henderson expressly refused to state whether he had such statements in his possession (Tr 123; see Pet Br 10, n 9). His "denial" that "we" had them was ambiguous in view of his refusal and was limited to statements deemed by him to be subject to production under the Board's regulation (Tr 128).

to those which have already been made available * * *"

Petitioners again tried to determine if General Counsel had used or had access to the statements in preparing his case. Mr. Henderson refused to answer their questions. When he was asked

> "* * * whether they had access to the statements taken by any of the other departments or discussed the contents of those statements with people in the other departments?"

his answer was

> "No, my statement doesn't go to that. That, I don't know." (Tr 1017)

He refused to disclose whether the Washington office had any notes of the statements and denied having personal familiarity with the Washington files (Tr 1017). After further refusals to give such information (Tr 1018) the following occurred:

> "MR. ELLIOTT: Then to recapitulate, do I understand, Mr. Henderson, that you are not authorized to state whether or not anyone in the General Counsel's office has seen, reviewed or taken notes of any statements in the possession of any other agency?
>
> MR. HENDERSON: You are correct; I am not." (Tr 1019)[3]

3. The foregoing portions of the transcript demonstrate the gross inaccuracy of the Board's conclusion that petitioners merely sought to question Mr. Henderson about "the contents of the Board's files and the Board's investigation of the case" (Bd Br 16).

General Counsel had refused petitioners' request that Mr. Henderson and Mr. Stratton be permitted to testify about the statements (Tr 531-533). However, after stating that he could add nothing to General Counsel's official statement, Mr. Henderson said that "we" had not destroyed or given back any statements (Tr 1018-1019). This denial, which could not be tested by cross examination, gives graphic substance to petitioner' complaint:

> "* * * I want to point out for the record that now General Counsel can testify without the permission of the Board; but when we have problems that we need clarified, this can't be done." (Tr 409; see also Tr 411, 543-546)[4]

The Board contends that the regulation is comprehensive and exclusive in Board proceedings; that no statements not in the present possession of General Counsel and within the regulation as construed by him alone can be secured from him or anyone else, even by subpoena; and that he need not give any information about them or his use of them (R 130; Bd Br 35-37, 43-44).[5] This position is of such far reaching importance as to make the Board's reliance on what it now asserts to be the record little more than a screen for its much more ambitious claim.[6] If it is approved it can only be

4. Compare the Board's present claim that it "made every effort to accord petitioners every right to which all parties appearing before it are entitled" (Bd Br 49, see also Bd Br 30).

5. The Trial Examiner agreed with this analysis (Tr 990, 993).

6. Compare the thorough search of Government files and full disclosure by Government counsel in *US v. Paroutian*, (CA 2 1963) 319 F2d 661 at 664, in which it was doubtful if a statement had been taken.

because the ultimate decision whether to comply with *Jencks* rests in the administrator's discretion.

II.

The Board describes its decision below as holding only that

> "* * * The Board held that counsel for the General Counsel had given to petitioners copies of all the witnesses' statements in his possession, and that petitioners were not entitled to anything else upon demand as a matter of right (R. 129-130)." (Bd Br 17)

This misleading description must be compared with the much broader and detailed terms of its actual decision (R 130). Counsel's reference tends to conceal the improper basis on which the Board resolved these questions and the claims which it actually asserts in this case.

III.

The Board ignores petitioners' contention (Pet Br 36-47) that General Counsel asserts an exclusive and non-reviewable authority to determine what is producible under the law and its regulation.[7] That authority would follow, however, from the Board's repeated suggestion that *Jencks* is merely a procedural device, that the adoption of the proviso to Reg § 102.118 was a voluntary concession to those appearing before it,

7. While Mr. Henderson offered to turn over to the Trial Examiner everything in his own file which might be considered to be a statement subject to production under the regulation, the Board's General Counsel made no such offer.

that "the Board's rule, not *Jencks*, controls", and that the Board merely "adapted" *Jencks* "to the requirements of its proceedings" (Bd Br 36-37).[8] The Court should well consider the Board's effort to turn a basic requirement of fair play into a matter of administrative grace. *Jencks* is not merely a rule for the production of impeaching evidence; it requires disclosure of the facts relating to that evidence (Pet Br 39-43), and it was imposed on the Board, as on other administrative bodies, by judicial insistence.[9] The questions in this proceeding, which the Board does not answer, are whether the regulation as construed by the Board complies with the rule, whether it was properly construed, and whether its application was not arbitrary and unreasonable.

IV.

The Board's brief contains other errors, both of fact and implication.

a. The Board complains that petitioners were not interested in seeing the statements, but only in making a technical record and "laying procedural traps" (Bd Br 10, 30). These charges are patently untrue. Mr. Lubersky did, indeed, insist on questioning Mr. Henderson under oath after he had made the general statement that "we do not have the statements" and that he would

8. See also Bd Br 43:
"* * * *Jencks* does not apply to Board proceedings except insofar as its precept has been incorporated in the proviso to Section 102.118. * * *"
The Board relies on § 10(b) of the Act (not § 10(c) as it states) in asserting that the "rules of evidence" to which it "adapted" *Jencks* are those set forth in the Federal Rules of Civil Procedure (Bd Br 36-37).

9. *NLRB v. Adhesive Products Corp.*, (CA 2 1958) 258 F2d 403 at 408; *Communist Party v. SACB*, (CA DC 1958) 254 F2d 314 at 328.

say nothing more (Tr 117-119). The questions, far from being "loaded" (Bd Br 32, n 19) or a "trap", were of obvious benefit to General Counsel, for they specifically described the nature and extent of petitioners' demands and illustrated the importance they attached to the questions involved. The Board cannot be serious in suggesting that petitioners' counsel should fail to make a record of their position for consideration by this Court.

The further statement (Bd Br 30) that petitioners sought to "prevent Henderson from testifying as to whether he had any notes of an interview with Moore" is also incorrect. Petitioners did not do so (Tr 403); they objected only to his self-serving elaboration of that testimony seeking to explain how he happened to know that he had none and his attempt to impeach the testimony of his own witness that notes were in fact taken (Tr 405-407).

b. Contrary to the Board's statement (Bd Br 9; see Pet Br 48), the record does not disclose the purpose of the Department of Labor and the FBI in taking the witness statements (see Tr 114, 144 cited by the Board), nor does it disprove petitioners' suggestion of interagency cooperation in making evidence available for use by an agency other than the one which acquired it. The Board admits that if the FBI or the Department of Labor were "aiding the Board in its investigation, * * * the Board would, of course, have been under a duty to produce the statements" (Bd Br 37).[10] Surely,

10. This is inconsistent with the Board's position elsewhere (Bd Br 35-37, 43-44) that under Reg § 102.118 only statements in the present possession of General Counsel can be secured, even by subpoena.

then, the Board must admit that petitioners were entitled to be advised whether the statements had been made available to General Counsel in aid of his case.

c. The Board does not deny that part of the Hahn memorandum was in a form subject to production (Tr 344; Bd Br 12-14, 45-47), but relies in support of the failure to produce it on the Trial Examiner's conclusion, after much uncertainty, that it added nothing to the affidavit already given petitioners and contained only the impressions of Mr. Stratton (Tr 352-354). It ignores the Trial Examiner's statement that there might be inconsistencies between the memorandum and the affidavit (Tr 344), Mr. Lubersky's statement that he wanted to examine it (Tr 334), and the Trial Examiner's reliance on the Jencks Act, which counsel claims is not applicable to Board proceedings (Tr 349-350; Bd Br 36).[11]

d. The Board contends that the regulation substantively limits petitioners to witness statements currently in General Counsel's possession, and that statements cannot be subpoenaed from anyone else, because this would lead to the production of documents not described in the regulation.[12] It seeks to sustain its position by asserting that it has no authority over the files of other agencies and that its subpoenas cannot run to the heads of other departments (Tr 993, 996; Bd Br 19,

11. The Board originally agreed with the Trial Examiner that the Act applied (R 130), but has apparently changed its position on this appeal.

12. Contrary to the Board's suggestion (Bd Br 11), the subpoenas to General Counsel, the Secretary of Labor and the Attorney General, although completed on June 14, were not served until June 21 (see Tr 136; Exhs 1A, 1B and 1C).

35-36, 43-44; see R 130). No authority is cited in support of any of these contentions, and they are incorrect.[13]

Reg § 102.118 is not a restriction upon and does not relate to the subpoena power or the right of a respondent to secure evidence for its defense. It concerns only General Counsel's obligation to produce witness statements, not anyone else's. It is neither exclusive nor comprehensive, and there is no limitation in either the statute or the applicable regulation on persons to whom or the evidence for which Board subpoenas will issue, provided only that the evidence required to be produced is sufficiently described and is relevant to the proceeding. Neither the Trial Examiner nor the Board is given any discretion in issuing them (*NLRB v. Duval Jewelry Co.*, (1958) 357 US 1).[14] Legal objections to complying with them can be asserted by the persons subpoenaed, including agency heads, in enforcement proceedings in District Court. This was obviously the procedure contemplated by Congress in enacting § 11(1) of the 1947 Act, and it is the only procedure which is consistent with its clear and unambiguous terms.[15]

e. The Board seeks to distinguish between impeaching and substantive evidence and argues that petitioners

13. As to the second proposition, see Pet Br 72-74; *Machin v. Zuckert, Secretary of the Air Force*, (CA DC 1963) 316 F2d 336. As previously shown, a deliberate failure to retain possession of such statements or copies would itself amount to a wilful failure to produce them (Pet Br 44 and cases there cited).

14. 78 S Ct 1024, 2 L Ed 2d 1097.

15. The Board's position does not reach the further question whether, on these facts, there was a duty to attempt under § 11(6) of the Act to secure the statements from the other agencies for petitioners' use.

failed to make a sufficient showing of "need" to justify production of merely impeaching evidence (Bd Br 26, 32-33, 38-39). It asserts that *Tomlinson of High Point, Inc.*, (1947) 74 NLRB 681 and *Carpenters' Local Union No. 224 (etc.)*, (1961) 132 NLRB 295 are inapplicable, because the evidence referred to in those cases was substantive, not impeaching evidence (Bd Br 38-39).

1. No authority has been cited supporting the view that petitioners' rights (or need) are controlled by the substantive or impeaching nature of the evidence. In *Carpenters' Local,* indeed, the Board expressly stated that it would disregard the testimony of the witness, *because he could not be adequately cross examined by respondents without the evidence which the state agency refused to produce* (at 298). The charge was dismissed, because without his testimony there was no evidence of a violation.

2. Under *Jencks v. US*, (1957) 353 US 657,[16] a conclusive showing of need is made when it is shown that the statements were given to the Government (see Pet Br 30-32).[17] It was the very heart of *Jencks* that impeaching evidence is important evidence and that an improper refusal to produce it is a denial of right.

3. Furthermore, subpoenas would issue for substantive evidence in the possession of third persons, and

16. 77 S Ct 1007, 1 L Ed 2d 1103.

17. The reason is obvious and simple:

> "* * * the determination of whether a conflict between the testimony and the documentary evidence exists cannot be made without the inspection by the court of the pertinent documents."
>
> *Schauffler v. Local No. 107*, (DC ED Pa 1960) 196 F Supp 471 at 473, by Ganey, J.

See also *State v. Ashton*, (Ariz 1963) 386 P2d 83 at 84-85.

these statements would be a proper (and probable) source of such evidence.

4. This is not simply a case of official inaction. General Counsel's unexplained refusals to furnish information about the statements or to permit his agents to do so, or to request the statements from other agencies, and the Trial Examiner's revocation, since affirmed, of the subpoenas directed to their chiefs, were affirmative acts which hindered petitioners and suppressed the facts, and which prevent the Board from contending in this Court that they failed to establish any "need" or "good cause" for examining the statements. This record is the Board's own creature. It admits that the statements were given and that they related to the witnesses' testimony on direct examination. The record shows that General Counsel aided in the effort to avoid producing them.[18] This conclusively satisfied any conceivable criterion of "need".

f. In the same vein, the Board cites Rule 34 of the Federal Rules of Civil Procedure and argues that it revoked the subpoenas for a lack of a showing of "good cause", a ground never before asserted (Bd Br 44-45).[19] Even if this were a permissible ground of revocation under § 11(1) of the Act, the same facts which establish petitioners' need also satisfy any requirement of

18. This assistance even extended to Mr. Henderson's purported representation of the Attorney General and the Secretary of Labor in moving to revoke the subpoenas.

19. The Board does not explain how the reference to the federal rules in § 10(b) can operate to destroy the limitation on the Board's power to revoke its subpoenas contained in § 11(1). Those rules are only to be applied "so far as practicable," and they clearly do not authorize substantive changes in other provisions of the statute.

"good cause" under Rule 34, and the contention is without merit. See 4 Moore's Federal Practice (2d ed 1963) 2460-2461 (§ 34.10).

The proper application of *Jencks* to Board proceedings is an independent requirement which cannot be avoided by reference to the same federal rules which the Board ignores in arguing that it could deny petitioners the deposition of Lee Caldwell (Bd Br 47-48).[20] The Board, it seems, will rely on § 10(b) to avoid an obligation, but rejects it when it would impose one.

g. The Board contends that the subpoena to General Counsel extended to material not subject to production under *Jencks*,[21] and that General Counsel's statement in his petition to revoke, that the "documentary evidence required to be produced in response to the subpena" is in Regional and other files under his control "*could have* referred merely to that material" (Bd Br 30-31; emphasis supplied). It supports this devious suggestion by a wholly irrelevant reference to Mr. Henderson's earlier examination of his own file and concludes that "it is quite clear" that this is what the admission referred to. However, as shown above (supra 2, 4), Mr. Henderson repeatedly disclaimed familiarity with anything but the current contents of his own trial file, and the admission remains unexplained in the record.

20. Similarly, the Federal Rules of Criminal Procedure make no reference to the *Jencks* principle, but it was not for that reason inapplicable to criminal proceedings, even before the Jencks Act was passed.

21. Contrary to the Board's assertion, petitioners have never contended that they should be allowed to sack through General Counsel's files; they would not if they could (Tr 995; see Bd Br 30, n 18).

h. The Board contends (Bd Br 38) that its failure to request the statements from the other agencies under § 11(6) of the Act did not prejudice petitioners, because the FBI and the Department of Labor had petitioned for revocation of the subpoenas, and the request would have "added nothing". It would, of course, have added substantially to the situation after the subpoenas were revoked, even if we assume that Mr. Henderson had authority to file the petitions. A request under § 11(6) must be honored under presidential direction and might well have been honored voluntarily without it; the petitions for revocation are not conclusive of the agencies' position in other circumstances. In this case, the Board ran interference, and they were never required to make a decision. The Board cannot assert that there was no prejudice.

i. The Board concedes that *NLRB v. Cashman Auto Co.*, (CA 1 1955) 223 F2d 832, like *NLRB v. Duval Jewelry Co.*, supra, (1958) 357 US 1 at 7, holds that the Board's power to revoke its subpoenas is limited to the grounds in the statute, and that neither ground is involved here (Bd Br 41-43). It refers to, but disclaims reliance upon the further holding in *Cashman Auto* that the respondent there had waived its rights by failing to seek enforcement. It states:

> "* * * The record is barren of any request by petitioners that the General Counsel seek judicial enforcement of the subpoenas." (Bd Br 41)

This is incorrect. Petitioners made a specific request for judicial enforcement of the subpoenas (Tr 219).

Furthermore, as pointed out by petitioners (Pet Br 68), the court was not faced in *Cashman Auto* with the improper allowance of a petition to revoke, for in that case there was no such petition. Instead, there was an independent refusal to obey the subpoena—a refusal made outside the proceedings. In this case there was no disobedience to the subpoenas, but only their wrongful revocation by the Trial Examiner, since affirmed, which left nothing to enforce.

Counsel's argument that administrative convenience requires that *Duval Jewelry Co.* and *Cashman Auto* be rejected and that the statutory grounds of revocation should be regarded as "illustrative only" (Bd Br 42) is unconvincing. Federal District Courts pass daily upon discovery claims in civil litigation and will scarcely collapse under the weight of an occasional enforcement proceeding.

The cases cited (but not discussed) by the Board in support of its position (Bd Br 42-43), insofar as they relate at all to the revocation of its subpoenas under present law, are cases in which the applicant sought to penetrate the Board's own files.[22] They hold only that the "simple requirements" of Board regulations controlling its own files are controlling in the absence of any showing of need.[23] They did not concern subpoenas

22. See *NLRB v. Jamestown Sterling Corp.*, (CA 2 1954) 211 F2d 725; *NLRB v. Quest-Shon Mark Brassiere Co.*, (CA 2 1950) 185 F2d 285, cert den (1951) 342 US 812. In *NLRB v. Thayer Co.*, (CA 1 1954) 213 F2d 748, cert den (1954) 348 US 883, which was decided three years before *Jencks*, the court expressly disregarded the Government's contention that the revocation was proper under Reg § 102.31, but held that the petitioners had made no showing under substantive law entitling them to production of the statements.

23. The Board does, of course, have limited statutory authority to control its own files (Pet Br 54).

directed to third persons or defenses or objections which such persons might have to complying with them, nor was the present question of the Board's basic authority under the law mentioned or discussed.

Finally, even if the Board's position were correct, none of the non-statutory grounds asserted in the petitions and relied on by the Trial Examiner were legally sufficient to support the order of revocation (Pet Br 62-77).

j. The Board suggests (Bd Br 44-45) that impeachment of these three witnesses would have been merely cumulative, because they were already shown to be unreliable. These, however, were witnesses whom the Trial Examiner and the Board believed and relied on and for whose credibility General Counsel vouched. Impeachment of their direct testimony, was obviously of critical importance, and the Board cannot assert that it already knows they were lying.

k. The Trial Examiner erred in denying petitioners' motion for the deposition of Lee Caldwell. Petitioners have never suggested that this witness' "testimony after the recess would be different" (see Bd Br 47-48). Rather, in view of the admitted perjured testimony already received and the generally low character of the Government's witnesses, the deposition was peculiarly necessary so that a rebuttal could be prepared. There was a conclusive showing of "good cause" which terminated the Trial Examiner's discretion under Reg § 102.30, and the motion should have been allowed. This position, we submit, is fully "worthy of reply".[24]

24. Indeed, Mr. Caldwell's testimony was contradicted by Mr. Evans, an agent of the Department of Labor (Tr 2768).

V.

a. The Board admits that "thievery was rampant" (Bd Br 27). The ultimate issue in the case is whether Wallace Ummel investigated that thievery or union activity. On appeal, the question is whether the record supports the finding that it did the latter.

The testimony of the Government's witnesses was believed, because the Trial Examiner found that Cronkrite's testimony contained "inherent improbabilities" and should not be believed because he "admitted that no action was taken about the reports of thefts which were made" (Bd Br 27; R 164).

The Board has again overreached the record. Action was taken. The information was turned over to the Sheriff of Wasco County, Oregon and the District Attorney was consulted (Pet Br 104). However, the mistaken conclusion that Harvey made no use of the theft reports was the basis on which the Trial Examiner and the Board accepted the testimony of the Government's witnesses (Pet Br 101). It led them to disbelieve Cronkrite's testimony, and that disbelief was the touchstone which, as if by magic, rendered credible the testimony of Davis, Hahn and Moore, and also of Mr. and Mrs. Siemens (Bd Br 27; R 164). But for this mistake regarding the "non use" of the reports, Cronkrite's testimony would have been credited (Pet Br 101; Bd Br 27); if it had been, no finding of an unfair labor practice could have been made.

The record also shows that no use was made of the alleged reports of union activity, and that there was no

discrimination against any employee because of union sympathy. All of the affirmative evidence was to the contrary (Pet Br 95), and the Board does not deny it. Furthermore, in *General Engineering, Inc. v. NLRB*, (CA 9 1963) 311 F2d 570 this Court considered the record of an NLRB election held at Harvey's plant at The Dalles, Oregon in August, 1961. The charging party in this case was on that ballot and lost. The election was held after the period of alleged labor espionage (June-September, 1960) and at a time when the Board and the charging party knew all of the circumstances relating to the present charge. In fact, that election was held during the month in which the hearing in this case finally ended. No objections were filed to the election, and this Court held that

> "* * * it is unquestioned that this election was properly held under circumstances which permitted the employees to freely choose their bargaining representative without restraint, coercion, threatened reprisals or interference by petitioners. In our view, such certificate makes moot all portions of the order under review which relate to the representation case. * * *" (311 F2d at 572)

If the espionage activities complained of had actually occurred as charged in this case, the election could not possibly have been held under circumstances completely free of "restraint, coercion, threatened reprisals or interference", nor would the charging party have failed to raise the question.

If the alleged non use by Harvey of the thievery reports establishes that Cronkrite's testimony is unbeliev-

able and that the testimony of the Government's witnesses should be credited, the non use of the alleged espionage reports equally compels the conclusion that those who testified about them also lied, that there was in fact no espionage and that charging party and its purchased witnesses knew it. In short, if conclusions are to be drawn from the use or non use of reports, those conclusions support the testimony of Cronkrite and contradict the testimony of the Government's witnesses.[25]

b. The Board admits that "the only direct evidence" of labor espionage "is contained in the testimony of Davis, Hahn and Moore" (Bd Br 26), but argues pro forma that its findings are nevertheless supported by indirect evidence in the form of testimony of Frank Vernon Siemens and Mrs. Siemens (Bd Br 27). It fails to point out that the events in which Mr. and Mrs. Siemens were involved and about which they testified all occurred before any of the alleged espionage activities. Neither witness testified to any act of labor espionage, but only to an alleged intent to employ Ummel for such purpose at a later time. Consequently, the Siemens' testimony amounts only to evidence of that intent, not that it ever was carried out, and it does not constitute substantial or any evidence of the charges.

The record is devoid of any credible evidence of labor espionage. The findings below were erroneously bottomed on an unwarranted inference that Cronkrite's testimony was "incredible", which was in turn based

25. The Board would dispose of petitioners' case on the basis of Cronkrite's testimony alone. It ignores the testimony of numerous other employees of Wallace and Harvey which contradicted the Board's witnesses and fully supported the testimony of Cronkrite and Wallace Ummel (Pet Br 82-83).

upon the mistaken factual conclusion that the reports of thievery were not used.

CONCLUSION

The Board almost concedes that error was committed in the proceedings (Bd Br 49), but suggests that dismissal of the charges would be improper because its conduct was not wilful. We think the record supports no other conclusion but that the Board in a proceeding which it knew was protracted and of intolerable expense to the parties, in which its case was weak and the charges serious, wilfully and deliberately violated petitioners' rights. Any rehearing would have to be conducted before a different Trial Examiner, one who has not already resolved questions of credibility in his own mind, and would be as protracted and costly as the first one. The inequity and prejudice of further proceedings require that the order of the Board be reversed and set aside.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of the foregoing brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

_____

Attorney

No. 18,275

IN THE

United States Court of Appeals

For the Ninth Circuit

RAYMOND L. STOVER, et al.,
Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the Judgment of the United States District Court for the Northern District of California, Northern Division

Honorable Sherrill Halbert, Judge

APPELLANTS' OPENING BRIEF

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Subject Index

IV

V

Table of Authorities Cited

Cases

Statutes

Constitutions

Congressional Reports

Texts

No. 18,275

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APPELLANTS' OPENING BRIEF

I

PLEADINGS AND FACTS DISCLOSING JURISDICTION

The plaintiffs in these consolidated cases seek to recover from the defendant United States under the Federal Tort Claims Act approximately $13,000,000 for damages suffered by one hundred and sixty-four plaintiffs which damage occurred in December 1955 in Yuba and Sutter Counties of California when federally constructed levees collapsed along the Feather River and its tributaries. The complaints assert causes of action for negligence in the plan,

design, construction, maintenance and operation of the levees and other works comprising the Sacramento River Flood Control Project.

Jurisdiction in the federal courts is asserted under the Federal Tort Claims Act (28 USC Sec. 1346 and 2671 et seq.)

In its answer to the complaints here involved the United States asserted as an affirmative defense the provisions of Title 33 USC 702c which state:

> "No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place. . . ."

The Trial Court ruled that this code section (702c) constituted an affirmative defense, and ordered a trial on this special defense for all the pending cases. At the conclusion of this trial solely on this special issue the Trial Court ruled:

> "Said Section 702c provides the United States of America with a complete legal defense in these actions." (Cl. Tr. 77)

II

STATEMENT OF THE CASE

Over a period of approximately half a century prior to 1955 the Federal Government, together with the State of California, planned, designed and constructed an extensive system for flood control in the Sacramento Valley in California. This flood control project included a system of levees on the Feather River and its tributaries.

The Feather River basin is located on the western slope of the Sierra Nevada Mountain range, northeasterly from the Sacramento Valley. The basin includes the drainage areas of the Feather River and its tributaries, principally the Yuba and Bear Rivers, and covers approximately 5,900 square miles ranging in elevation from about 30 feet to about 10,000 feet. (R.T. 320-321.)

During the early part of December, 1955, two storms swept over the entire Feather River basin. This early rainfall prepared the ground for the later disastrous events by soaking the soil to a near saturation point. On December 16, the first major storm of a series arrived at the Feather River basin. It was a warm-type storm and extended over the entire area, climaxing in heavy rain on the 18th and 19th. Snow fell during this storm only at elevations above 6,000 feet. Since the soil had been primed earlier, rivers and streams rose sharply. A second major storm followed on the 21st and 22nd and this was followed by a third warm storm on the 22nd and 23rd of December. (R.T. 361-364.)

The water from all these storms drained into the levee system on the Feather. Prior to December 23, 1955, these waters had overflowed the natural banks of the Feather, Yuba, and Bear Rivers but were being contained by the levees.

On December 23-24, 1955, breaks occurred at three points in these levees resulting in inundation of approximately 85,000 acres. (R.T. 323:1.) One of these breaks, referred to as the Gum Tree break, took place

in the right levee of the Feather River just downstream from Yuba City a short distance downstream from the confluence of the Feather and Yuba Rivers, and was a specific factor in the inundation of Yuba City. A second break occurred in the left levee of the Feather River just downstream from the town of Nicolaus a short distance downstream from the confluence of the Feather and Bear Rivers, and is referred to as the Nicolaus break. A third area of inundation, caused by a series of breaks, occurred to the west of the right levee of the Western Pacific Interceptor Canal which normally drains into the Bear River from the North. (R.T. 323-336.)

As a result of these levee breaks, water flowed over lands of the Feather River Basin, causing the damage of which plaintiffs complain.

The Trial Court found, as a fact, that the streamflow at the time of these levee breaks resulted from what it termed "unusual and extraordinary climatic conditions", ruled that water which has overflowed the natural banks of a stream is "flood water" even though that water is contained by a system of levees, and therefore the Trial Court ruled, the United States Government cannot be held liable for negligence or deliberate conduct in the plan, design or construction of the levee system even though such negligent or deliberate conduct proximately caused the levee breaks and the resulting destruction.

The Trial Court specifically ruled that "proximate cause" was not an issue in the case even though plaintiffs offered to prove that the Gum Tree and Nicolaus

breaks were proximately caused by the deliberate act of the Federal Government in the summer of 1955 in diverting approximately 60,000 cfs of water from its natural drainage in the vicinity of Hamilton Bend near Oroville on the Feather and thus causing that 60,000 cfs of water to flow to Gum Tree and Nicolaus which nature never would have brought within twenty-five miles of these locations.

The Trial Court specifically refused to permit plaintiffs to prove the amount of water which was flowing within the confines of the levees at the time of each break even though plaintiffs desired to prove that the Government knew that the amount which flowed at Gum Tree at the time of the break was approximately 300,000 cfs, that the 60,000 cfs diverted in the vicinity of Hamilton Bend increased the flow at Gum Tree and Nicolaus from safe channel capacity to an amount which caused the breaks, and that when the section of levee on the right bank of the Feather (referred to as the Cox Ranch-Hamilton Bend levee) was constructed in the summer of 1955 the Federal Government knew that four times in the preceding fifty years the amount of water flowing at the scene of the Gum Tree break would have exceeded the safe channel capacity except for the fact that a large volume of water had historically flowed west at Hamilton Bend across the plains north of the Sutter Buttes and into the Butte Basin on the west side of the Sutter Buttes. The 1955 levee construction by the Government closed this natural spillway and rendered inevitable the Gum Tree and Nicolaus breaks in December of 1955, but

the Trial Court ruled that these facts were "immaterial" to any issue in the case.

Plaintiffs offered to prove many negligent acts of the United States Government which each proximately contributed as a cause of each levee break but the Trial Court sustained objections to the introduction of such proof. The specific offers of proof will be referred to in this brief under the heading "*Specifications of Errors Relied Upon By Appellants* III."

In a broad sense the Trial Court took the position that Section 702c created a defense in a case involving damage from a natural flood. Plaintiffs were prepared to prove that the flood was not a natural flood, but a *man-made flood.* The Trial Court refused to permit plaintiffs to even introduce evidence to support their contention that this was a man-made flood.

Thus we come to the KEY POINT OF THE CASE which is not whether there was a flood, but whether the flood on plaintiff's lands was a natural flood or a man-made flood.

The Trial Court was pre-occupied with the question whether there was a flood, gave lip-service to the proposition that the issue in the case was whether the flood was man-made or natural, but consistently refused to hear any evidence tending to prove the flood on plaintiff's lands was man-made.

THE ISSUE IS NOT WHETHER THERE WAS A FLOOD. OF COURSE THERE WAS A FLOOD.

The issue is whether this flood was the type of flood meant by Congress when it said "no liability shall

attach . . . for any damage by or from floods or flood waters."

The case involved two major points:

1. Was there a flood?
2. Was this flood natural or man-made?

The Trial Court never reached the key point of the case.

III

SPECIFICATIONS OF ERRORS RELIED UPON BY APPELLANTS

A. The Trial Court erred in holding 33 USC 702c to be an immunity statute.

1. In the course of the trial, the Court stated that Section 702c would not create immunity from intentional conduct by the government, but would create immunity from negligent conduct.

The following portion of the Reporter's Transcript will illustrate (R.T. 508:3-510:25):

> "Mr. Watt. The question is what is the definition—as I understand the Court at the moment, the Court is trying to help us by defining flood as water which covers the land, but as water of a particular character; that is, water from unusual or extraordinary climatic conditions.
>
> Our problem is what are unusual or extraordinary climatic conditions if they have been repeated every seven to ten to twelve years over a period of 100 years?
>
> The Court. Mr. Watt, I don't think it makes one whit of a difference. In other words, if it happened every year for a hundred years that

is not the issue. The issue is, was there a flood of water which inundated an area of the surface of the earth where it ordinarily would not have been expected to be which resulted—I keep trying to shy away from that Act of God description, because I think it is inept, probably more inept than what I have said here; but all I am trying to say is that we are talking about, to boil it down to those terms, an Act of God situation as distinguished from a man-made situation, and I won't back away one bit from the description that I have made of a man-made flood.

The term 'man-made flood' means a flood which is created solely by the construction or fabrication of a barrier which impounds a substantial quantity of water which but for the barrier would not have been impounded.

Maybe I can do it the other way around and say that unless this is a man-made flood it falls within 702(c).

Mr. Watt. Your Honor, I would respectfully suggest that that, I believe, doesn't quite get at our problem.

The Court. I think it simplifies it to the ultimate, Mr. Watt, that by saying unless this flood that is the subject of this suit here was a man-made flood the exemption of 702(c) is applicable.

Mr. Watt. This part I can follow, but we are still on the question of definition of flood.

The Court. Well, why worry about it, why worry about it? You can take the definition of a flood, and surely in the face of testimony that we have had here nobody would try to suggest to me there wasn't a flood in the Yuba-Marysville area.

Mr. Watt. As I suggested yesterday there are a few words in our language which only have a

single meaning; in the laymen's sense, of course, there was a flood. The water covered the land.

I think that the Court would readily agree that that alone is not what was meant by Congress in 702(c), so we have the further question of what type of water or what source of water, or the basic question which we have asked, whether combined with an act of man creates immunity or does not create immunity; but we have, for example, the question about Act of God, the question of what——

The Court. I am going to leave all that out. In other words, I am going to try to simplify this matter. For some reason I am not getting through to you, Mr. Watt. I am simply now saying that unless it can be shown that this was a man-made flood as defined by me in the pretrial order that it falls within the exemption of 702(c).

Mr. Watt. If there had been a gate there in the levee and a man had opened the gate even if this levee was full of water from unusual conditions, I respectfully——

The Court. That would be a man-made flood as distinguished from—as you, yourself, or Mr. Goldstein said, having the water in the area is not enough to make the flood. The flood is the escaping of the water.

A person could not wilfully and deliberately and maliciously open a gate that would ordinarily have everybody secure from it and turn the water out, and then say because this was from a source up above, and the source was a rain, that the Government is excused from it.

Mr. Watt. If it were negligently opened as distinct from willfully, would not the same result apply?

The Court. If it could be shown to me that there would have been—no, I am not going to walk into that, I am not going to walk into that. I am going to stay with what I have said here on the thing."

2. **A little later the Trial Court indicated that even deliberate, intentional conduct by the government would be immune under Section 702c, as the Transcript reads at page 537 (R.T. 537:1-22):**

"The Court. Well, I must compliment you, Mr. Watt. You are making your position a great deal clearer to me than I am apparently making my position clear to you. I never had any doubt from the time we first started the hearings that this was precisely the position of the Plaintiffs in this case, and it is still the position of the Plaintiffs in this case, and to the contrary it is my position that under the law it doesn't make any difference what the Government did, whether it was wrong, or whether it was inept or whether it was a miscalculation, a mis-judgment, or was grossly negligent, if this was flood water what was coming down there, the Government is not liable under 702(c) as I interpret that section, and, as I take it, the Court of Appeals has interpreted that section.

Mr. Watt. Do I understand the Court that even if we prove that the Government deliberately constructed that last portion of the levees so that they deliberately diverted this water down, which would be the same as deliberately opening the gates that we talked about a little bit earlier this morning, that there would be no liability?

The Court. It is my opinion that this was a flood under the category that I have discussed."

3. **The Trial Court specifically ruled that Section 702c was an immunity statute. In its "Memorandum and Order" dated April 23, 1962, the Court said (Cl. Tr. 75):**

> "In ascribing meaning to § 702c, I have seen nothing during the course of the trial to cause me to retreat from the preliminary determination I made in the pre-trial order of November 21, 1961. It appears that § 702c was, and is, intended to save the United States harmless from liability in cases involving natural floods, or flood waters, whether or not there is a concurrence of negligence with such flood waters. It is not, however, intended to extend to inundations of an artificial nature, solely caused by the instrumentalities of man."

4. **The Trial Court ruled that the immunity applied if there was a flood resulting in whole or in part from unusual or extraordinary climatic conditions even if negligence of the government was a contributing proximate cause, but that Section 702c does not apply to a "man-made flood" which resulted solely from negligent acts, saying (Cl. Tr. 77):**

> "4. Title 33 U.S.C. § 702c applies to all floods and flood waters which result *in whole or in part* from unusual or extraordinary climatic conditions, that is, from climatic conditions which are so severe that a reasonably prudent man using ordinary care would expect a flood to occur as a result of such conditions.
>
> 5. The term 'man-made flood' means a flood (as previously defined) which is created *solely* by the construction or fabrication of a barrier which impounds a substantial quantity of water which, but for the barrier, would not have been impounded.

6. Title 33 U.S.C. § 702c does not apply to 'man-made floods' which result *solely* from negligent acts.

7. The waters which inundated certain of plaintiffs' lands as a result of the breaks in the levee system at Gum Tree, Nicolaus, and Western Pacific Interceptor Canal, were part of a flood, within the meaning of the terms 'floods or flood waters' as used in Title 33 U.S.C. § 702c. Section 702c of Title 33 U.S.C. therefore provides the defendant, United States of America, with a complete legal defense to these actions."

We respectfully submit that Section 702c was not intended to be an immunity statute, but was merely a legislative recognition of the legal principle that the government is not liable for damage proximately caused *solely* by the elements or nature, but that Section 702c does not alter the basic principle of concurrent conduct and therefore the Government is liable where its negligence is a concurring cause of damage. The "legal equation" of Act of God plus negligent Act of Man equals liability for man is not altered by Section 702c. The Trial Court mistakenly ruled that Section 702c altered this basic legal concept.

B. The Trial Court erred in holding that proximate cause was not an issue in the case.

1. The Trial Court took the view that if waters resulted from unusual precipitation, such waters were "flood waters", that if such waters flowed through a levee break and damaged plaintiffs' lands the cause of the levee break was immaterial.

The Court said (R.T. 427:9-428:1):

"The definitive issue is not precisely what water, snow fell up in this watershed area, but it

is what water actually get down to the area that is involved in this action here, and you can't very well bisect or dissect the matter, however you want to put it, and separate them. I listened to the testimony with reference to the rainfall because as I illustrated earlier, if this room drains all down to where I am seated here, somebdy dumps water up in one corner and somebody dumps water up in the other corner, I would naturally expect that a certain amount, if not all, of that water would get down here to my chair eventually, and so I have listened to the testimony with reference to precipitation, and I am perfectly willing to allow you to go into the matter of the flow of water if you so desire, not with the idea in mind that we are going into the question of whether or not the flow caused the breaks, because if the breaks resulted during the course of a flood, as I have defined it in the pre-trial order here, it becomes of no consequence in this case here."

2. **The Trial Court would not permit plaintiff to show that the levee breaks were a cause of damage to plaintiffs' property. The Dean of the Stanford University Department of Civil Engineering was on the stand (R.T. 629:23-630:7):**

"By Mr. Watt. Q. As an engineer, would you say that the levee break at Gum Tree was or was not *a* cause of the flood at Yuba City?

Mr. Spohn. If the Court please, another objection on that. It has the same effect as the previous question, and furthermore brings in this question of levee break which the Court has already defined as not being within the scope of this limited issue of whether or not the damage of which the plaintiffs complain was caused by flood or flood waters.

The Court. The objection will be sustained."

3. **The Trial Court erred in holding that the levee breaks were immaterial to the case and sustained objections to plaintiffs' questions concerning the cause of the levee breaks (Cl. Tr. 643:21-644:18):**

"Mr. Watt. If I understand the Court correctly, the Court's present view is that proximate cause is not an issue in this proceeding?

The Court. That's right.

Mr. Watt. Am I correct on that?

The Court. In other words, if 702(c) means what it says, and it is established to my satisfaction by a preponderance of the evidence that the waters involved in this case were either a flood or flood waters, it doesn't make any difference what happened after that.

Mr. Watt. Even if the Plaintiff's property would not have been even dampened had there not been negligence in the construction or the design of the levees?

The Court. I don't think that enters into the case at all at this time. It may later, but it doesn't now.

Mr. Watt. The Court appreciates that we are attempting to get to a position to show that this water on Plaintiffs' property was permitted to get there because of a break in the levee in which the sole proximate cause was the negligence of the Government?

The Court. That's my understanding of your position. I have understood it all the way along. At least I thought I did."

4. **In considering proposed amendments to the Pre-Trial Order the Court said (R.T. 694:15-20):**

"The Court. That is my view. In other words, the only issue here is whether or not there was unusual climatic conditions resulting in flood or

flood waters and the proximate cause of the injuries or the damages is not an issue in this proceeding here. It well may become later in other proceedings if there should be such proceedings."

5. **In its "Memorandum and Order" of April 23, 1962, the Court said (Cl. Tr. 71):**

"It is true, as plaintiffs point out, that causation is a basic issue in this action. But plaintiffs go too far in characterizing the causation required as 'proximate.' The statute reads only in terms of 'damage from or by floods or flood waters,' rather than a more explicit 'damage proximately resulting from floods or flood waters.' A concept of 'damage from' involves a consideration of actual, rather than proximate, causation. Thus, a determination of the causation issue must begin with the question of whether or not the inundations of which plaintiffs complain resulted, in whole *or in part,* from unusual or extraordinary climatic conditions. On the issue presently before me, it is of no consequence how negligent the Government may (or may not) have been, if it be shown that the inundations, even in part, resulted from, and were *actually* caused by, such natural forces."

We respectfully submit that in order to describe whether a flood was man-made or an "Act of God" the question of proximate cause must be considered and decided.

C. The Trial Court erred in refusing to receive any evidence on the issue of whether this flood was a man-made flood.

1. **In its "Memorandum and Order" of April 23, 1962, the Court said (Cl. Tr. 71):**

> "Plaintiffs have attempted, throughout these proceedings, to introduce evidence dealing with the negligence, or alleged negligence, of the United States in setting up, and administering, the Sacramento River Flood Control Project (which includes the Feather River and its tributaries). This evidence has been rejected at all times during the trial of the § 702c affirmative defense."

and held that

> "6 Title 33 USC Section 702c does not apply to man-made floods which result solely from negligent acts." (Cl. Tr. 77.)

and then decided that this was not a man-made flood without hearing evidence on that issue!

2. **After permitting evidence that the levee was man-made (R.T. 341:6-7) the Court consistently sustained objections to plaintiffs' attempt to prove that the flood on plaintiffs' land was man-made in the following instances:**

a. **Levees blocking natural drainage at Hamilton Bend (R.T. 343:14-344:1):**

> "Q. Before the levees were constructed in the area of Hamilton Bend, is it not correct to say that the natural drainage of the Feather River over the natural banks of the Feather at that point was to the West across the Sacramento Valley north of the Sutter Buttes and into the Butte Basin?
>
> Mr. Spohn. If the Court please, I'd object to that question and the line of testimony that it is

apparently designed to bring out, as being beyond the scope of the issues here involved. It is the same question that was raised by the Plaintiffs in their interrogatories in the Adams case, which were ruled as irrelevant by your Honor. It was raised again during the pre-trial conference. It goes far beyond the issues.

The Court. I will sustain the objection to the question."

b. Levees blocking natural drainage at Gilsizer Slough (R.T. 345:24-346:7):

"Q. And the Gilsizer Slough is a natural slough, was it not?

A. As far as I know from historical maps, there was a slough through that country known as Gilsizer Slough.

Q. And the levee on the west bank of the Feather in the vicinity of Yuba City was intended, among other things, to block the flow of water from the Feather into Gilsizer Slough?

Mr. Spohn. Object to the question, your Honor, as beyond the issues of this case as previously defined in the pre-trial order.

The Court. I will sustain the objection."

Plaintiffs were thus prevented from presenting evidence that the breaks in the man-made levee were caused by acts of man in substantially diverting water from natural drainage, in closing (in 1955) a natural relief spillway with full knowledge that the inevitable result would be over-loading the levees below Marysville.

3. **The following offers of proof were made by plaintiffs, but as to each the offers were rejected by the Court in sustaining objections by the defense:**

a. (R.T. 670:3-5):

"The Defendant, United States of America, planned, designed, and constructed the levee system involved in this litigation."

b. (R.T. 670:11-16):

"Last section of levee on the west side of the Feather River, that is, the Hamilton Bend-Cox Ranch gap, upstream from Yuba City was constructed in 1954 and 1955, and completed in June of 1955, and closed the last safety valve for water in excess of the designed capacity of the levee system on the Feather River."

c. (R.T. 670:21-22):

"The section of levee which failed at Nicolaus was completed in June of 1955."

d. (R.T. 670:25-671:3):

"The entire Sacramento River Flood Control Project operated successfully during the rains of December 1955, except the Feather River levees and Feather River tributaries."

e. (R.T. 671:7-9):

"The entire Sacramento River Flood Control Project was designed for an estimated flood frequency of once in 25 years."

f. (R.T. 671:13-18):

"The estimated long-time probable frequency of the Feather River flow exceeding the designed capacity of the leveed channel above the confluence of the Sutter by-pass was once in 15 years

prior to the closing of the Hamilton Bend-Cox Ranch gap in June of 1955."

g. (R.T. 671:21-23):

"The designed capacity for the Feather River upstream from Yuba City is 180,000 cubic feet per second."

h. (R.T. 672:24-25):

"The designed capacity of the Yuba River is 120,000 cubic feet."

i. (R.T. 674:20-21):

"the design capacity of the Bear River is 30,000 cubic feet per second."

j. (R.T. 675:20-21):

"the design capacity of the levee at Gum Tree was 277,000 cubic foot per second."

j. (R.T. 676:3-8):

"the design capacity of the levee at Gum Tree was 277,000 cubic feet per second, which amount of water flowing in the Feather and Yuba Rivers had been exceeded in times of high water in 1907, 1909, 1928, 1937, (all before the Hamilton Bend-Cox Ranch safety valve was closed in 1955)."

k. (R.T. 677:11-15):

"The design capacity of the levee at Nicolaus was 295,000 cubic feet per second, which amount of water flowing in the Feather, Yuba, and Bear Rivers had been exceeded in times of high water in 1907, 1909, 1928, and 1937 in addition to 1955."

l. (R.T. 677:20-24):

"The natural drainage of the Feather River for water in excess of the capacity of the natural

banks at Hamilton Bend is west across the Sacramento Valley north of the Sutter Buttes and into the Sutter Basin on the west side of the Sutter Buttes."

m. (R.T. 678:6-9):

"The levees constructed by the United States Government diverted all waters flowing down the Feather River, in excess of the capacity of the natural banks at Hamilton Bend, to Gum Tree and Nicolaus Breaks."

n. (R.T. 678:13-15):

"The water thus diverted from its natural drainage was a contributing proximate cause of the Gum Tree and Nicolaus Breaks."

o. (R.T. 678:18-20):

"The Gum Tree and Nicolaus breaks occurred without water flowing over the top of the levee at the scene of either break."

p. (R.T. 678:23-679:3):

"Between 1929 when the Hamilton Bend levee was completed and 1955 when the Hamilton Bend-Cox Ranch section of levee was constructed, all water in excess of 145,000 cubic feet per second naturally flowed west from the Feather River north of the Sutter Buttes and into the Sutter By-Pass on the west side of the Sutter Buttes."

p. plus (R.T. 679:12-13):

"This water before 1955 never reached the scene of the Gum Tree break or the Nicolaus break."

q. (R.T. 679:16-20):

"The approximate amount of water at the Nicolaus break at the time of that break which

was diverted by the Hamilton Bend-Cox Ranch levee from its natural drainage on the west of the Buttes to the scene of the Nicolaus break was 58,000 cubic feet per second."

r. (R.T. 679:23-680:2):

"The approximate amount of water at the Gum Tree break at the time of that break which was diverted by the Hamilton Bend-Cox Ranch levee from the natural drainage on the west of the Buttes to the scene of the Gum Tree was 58,000 cubic feet per second."

s. (R.T. 680:5-8):

"The 58,000 cubic feet per second of water referred to above proximately contributed to the break at Nicolaus and to the break at Gum Tree."

t. (R.T. 680:11-15):

"If the aforesaid 58,000 cubic feet per second of water had not been diverted from its natural drainage north and west of the Sutter Buttes neither the Gum Tree nor the Nicolaus breaks would have occurred."

u. (R.T. 680:18-21):

"The damage to plaintiffs' property would not have occurred except for the existence of the levee system of the Sacramento River Flood Control Project."

v. (R.T. 681:3-6):

"The Defendant United States was negligent in closing Hamilton Bend-Cox Ranch gap levee on the west side of the Feather River with knowl-

edge that flow exceeding designed capacity at Gum Tree and Nicolaus had occurred four times since 1907."

w. (R.T. 681:9-11):

"The defendant United States was negligent in building Gum Tree levee over the old river bed."

x. (R.T. 681:14-16):

"The defendant United States was negligent in failing to rock-face Gum Tree levee."

y. (R.T. 681:19-23):

"The defendant United States was negligent in moving the 'old Bow levee' position to a position 2000 feet nearer and directly opposite the mouth of the Yuba River, thus permitting the full force of the Yuba River to erode the Gum Tree levee."

z. (R.T. 682:1-3):

"The defendant United States was negligent in reconstructing the embankment at Nicolaus in 1955."

aa. (R.T. 682:6-8):

"The defendant United States was negligent in failing to rock-face high enough on levee at Nicolaus."

ab. (R.T. 682:11-16):

"On the Western Pacific interceptor canal, the United States negligently constructed levees on the interceptor canal at a lower height than the levees on the Bear River so that water from the Bear River flowed out the Western Pacific interceptor canal and broke the levees of the interceptor canal."

ac. (R.T. 683:5-10):

"At the time the Hamilton Bend-Cox Ranch gap on the west levee of the Feather was closed the defendant United States knew that its closing would cause more water than designed capacity to flow both at Gum Tree and at Nicolaus in times of reasonably expected high water."

ad. (R.T. 683:13-16):

"Had the Hamilton Bend-Cox Ranch gap levee not been closed the amount of water at both Gum Tree and Nicolaus at the time of each respective break would have been below the designed capacity."

ae. (R.T. 683:19-684:1):

"The United States knew that it should design the levees on the Feather River to hold waters on the Feather River above Marysville 26 per cent greater than the 1909 flow of 230,000 cubic feet per second, and 90 per cent greater than the 1909 flow of 111,000 cubic feet per second on the Yuba. The flow on both rivers at the time of the Gum Tree and Nicolaus breaks were far below these Government-anticipated flow figures."

af. (R.T. 684:4-7):

"The negligent plan, design, construction, maintenance or operation of Sacramento River Flood Control Project were each a proximate cause of the Gum Tree, Nicolaus, and Western Pacific interceptor canal breaks."

ag. (R.T. 684:10-11):

"The amount of rainfall was not the sole proximate cause of any of the breaks."

ah. (R.T. 684:14-15):

"The amount of rainfall was not a legal proximate cause of any of the breaks."

ai. (R.T. 684:20-685:1):

"The amount of precipitation which contributed to the water which injured the plaintiffs was reasonably foreseeable by:

(1) The United States Government, Corps of Engineers, and Weather Bureau, and

(2) a reasonably prudent person under the same or similar circumstances."

aj. (R.T. 685:20-686:1):

"The amount of flow which contributed to each break was reasonably foreseeable by:

(1) The United States Corps of Engineers and Weather Bureau, and

(2) a reasonably prudent person under the same or similar circumstances."

ak. (R.T. 686:5-7):

"The plan, design, construction and location of the levees and the flood control system on the Feather River and its tributaries."

Perhaps the Trial Court's analysis of this problem was colored by its puzzling view that levees *do not artificially confine water*. The Court said (R.T. 497:3-8):

"Mr. Watt. The levees were man-made, your Honor.

The Court. I understand they were, but the water that was coming down there wasn't artificially confined there by those levees.

Mr. Watt. May we suggest, your Honor, that this is precisely the point that we make, that it was."

IV

ARGUMENT

A. BASIC CONTENTION OF PLAINTIFFS.

The basic contention of Plaintiffs is that 33 USC 702c is a legislative recognition of the principle that the Government is not liable for damage proximately caused *solely* by an act of the elements, and that Section 702c does not prevent liability on the part of the United States where its negligence is either the *sole* proximate cause of damage, or proximately causes damage whether or not combined with an act of the elements or an "Act of God."

Plaintiffs specifically assert that Section 702c is not an immunity statute, and that the Government is liable under the Federal Tort Claims Act for negligent flood control activity.

B. CONGRESSIONAL HISTORY OF 33 USC 702.

The Trial Court confines its order for a separate trial to the affirmative defense of the United States to its claim of exemption from liability under Title 33, United States Code, Section 702c. However, we respectfully suggest that certain other Sections of the United States Code should be considered in order to

obtain the full meaning of the claimed "flood or flood waters" exemption.

While the Corps of Engineers of the United States Army had been working on flood control problems for many years, the first "Flood Control Act" setting forth a definite policy of flood control of the Congress of the United States was passed on March 1, 1917. This law contained four sections, which, in the United States Code Annotated, are now codified as follows:

Section 1—33 USCA 702 (Mississippi River);
Section 2—33 USCA 703 (Sacramento River);
Section 3—33 USCA 701 (Flood Control Generally);
Section 4—33 USCA 702 H (Placing flood control projects under Corps of Engineers).

The 1928 Flood Control Act was frequently spoken of as the "Second Flood Control Act." In 1927 the Mississippi River and its tributaries experienced an extensive flood in which 12,500,000 acres were inundated, 600,000 people were rendered homeless, and property was damaged to an extent of $400,000,000. (Congressional Record, 70th Congress, 1st Session, page 7118.) In the 1928 Congress (the 70th Congress) a detailed law was developed and passed for the purpose of controlling floods on the Mississippi and its tributaries. This law, known as Public Law No. 391, contained *fourteen* sections, only one of which (Section 13) in any way referred to territory outside the Mississippi watershed. The exception—Section 13—is now found in 33 USCA 704, and reads as follows:

"The project for the control of floods in the Sacramento River, California, adopted by section 703 of this title, is modified in accordance with the report of the California Debris Commission submitted in Senate Document Numbered 23, Sixty-ninth Congress, first session: *Provided,* That the total amounts contributed by the Federal Government, including the amounts heretofore contributed by it, shall in no event exceed in the aggregate $17,600,000. May 15, 1928, c. 569, sec. 13, 45 Stat. 539."

Other than this one quoted section, the entire 1928 flood control law dealt solely with the Mississippi River and its tributaries. *All* the provisions of the 1928 law except Section 13 (now 33 USCA 704) are now contained in the 702 series of Title 33, United States Code. The precise words here involved are:

"No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters in any place:"

(33 USCA 702.)

When the 1928 flood control bill was first presented to Congress, this language was not in the bill. The initial draft of the bill contained the following language:

"Just compensation shall be provided by the United States for all property used, taken, damaged, or destroyed in carrying out the flood control plan provided for herein."

(Congressional Record, 70th Congress, 1st Session, page 6665.)

There was a tremendous amount of discussion about this "Section 4" of the bill, ranging from urging enactment in the form just quoted, to leaving everyone to their rights under the Constitution.

Congressman Kopp said:

> "All the language in Section 4 of the bill enlarging the rule of damages fixed by the Constitution should be stricken out."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 6712.)

Congressman Davenport said:

> "Is there not protection enough against damage for them in the constitution?"
>
> (Cong. Rec., 70th Cong., 1st Session, p. 6716.)

Congressman Frear was criticizing the original "just compensation" provision when he was asked by *Congressman Cox:*

> "I would like to inquire of the gentleman if he favors the taking or damaging of private property for public use without compensation?"

To which *Congressman Frear* replied:

> "Why no; certainly not . . ."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 7000.)

Congressman Reid, in discussing the change to the bill as it was finally enacted said that the sense of the change is:

> ". . . that the government shall be liable where it diverts the water from the main channel."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 7001.)

In order to fully understand Congressman Reid's comment, we set forth here in full the pertinent sections referred to by Congressman Reid which are now 33 USCA 702b, 702c, and 702d, as follows:

702b:

"It is declared to be the sense of Congress that the principle of local contribution toward the cost of flood-control work, which has been incorporated in all previous national legislation on the subject, is sound, as recognizing the special interest of the local population in its own protection, and as a means of preventing inordinate requests for unjustified items of work having no material national interest. As a full compliance with this principle in view of the great expenditure estimated at approximately $292,000,000, prior to May 15, 1928, made by the local interests in the Alluvial Valley of the Mississippi River for protection against the floods of that river; in view of the extent of national concern in the control of these floods in the interests of national prosperity, the flow of interstate commerce, and the movement of the United States mails; and, in view of the gigantic scale of the project, involving flood waters of a volume and flowing from a drainage area largely outside the States most affected, and far exceeding those of any other river in the United States, no local contribution to the project herein adopted is required. May 15, 1928, c. 569, sec. 2, 45 Stat. 535."

702c:

"Except when authorized by the Secretary of the Army upon the recommendation of the Chief of

Engineers, no money appropriated under authority of sections 702a, 702b, 702d, 702e, 702g, 702h, 702j, 702k, 702l, and 702m of this title shall be expended on the construction of any item of the project until the States or levee districts have given assurances satisfactory to the Secretary of the Army that they will (a) maintain all flood-control works after their completion, except controlling and regulating spillway structures, including special relief levees; maintenance includes normally such matters as cutting grass, removal of weeds, local drainage, and minor repairs of main river levees; (b) agree to accept land turned over to them under the provisions of section 702d of this title; (c) provide without cost to the United States all rights of way for levee foundations and levees on the main stem of the Mississippi River between Cape Girardeau, Missouri, and the Head of Passes.

"No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place: *Provided however,* That if in carrying out the purposes of sections 702a, 702b-702d, 702e-702g, 702h-702j, 702k, 702l, and 702m of this title it shall be found that upon any stretch of the banks of the Mississippi River it is impracticable to construct levees, either because such construction is not economically justified or because such construction would unreasonably restrict the flood channel, and lands in such stretch of the river are subjected to overflow and damage which are not now overflowed or damaged by reason of the construction of levees on the opposite banks of the river it shall be the duty of the Secretary of the Army and the Chief

of Engineers to institute proceedings on behalf of the United States Government to acquire either the absolute ownership of the lands so subjected to overflow and damage or floodage rights over such lands. May 15, 1928, c. 569, sec. 3, 45 Stat. 535."

702d:

"The United States shall provide flowage rights for additional destructive flood waters that will pass by reason of diversions from the main channel of the Mississippi River: *Provided,* That in all cases where the execution of the flood-control plan herein adopted results in benefits to property such benefits shall be taken into consideration by way of reducing the amount of compensation to be paid.

"The Secretary of the Army may cause proceedings to be instituted for the acquirement by condemnation of any lands, easements, or rights of way which, in the opinion of the Secretary of the Army and the Chief of Engineers, are needed in carrying out this project, the said proceedings to be instituted in the United States district court for the district in which the land, easement, or right of way is located. In all such proceedings the practice, pleadings, forms, and modes or proceedings shall conform as near as may be to the practice, pleadings, forms, and proceedings existing at the time in like causes in the courts of record of the State within which such district court is held, any rule of the court to the contrary notwithstanding. When the owner of any land, easement, or right of way shall fix a price for the same, which, in the opinion of the Secretary of the Army is reasonable, he may purchase the

> same at such price; and the Secretary of the Army is also authorized to accept donations of land, easements, and rights of way required for this project. The provisions of sections 594 and 595 of this title are made applicable to the acquisition of lands, easements, or rights of way needed for works of flood control: *Provided,* That any land acquired under the provisions of this section shall be turned over without cost to the ownership of States or local interests. May 15, 1928, c. 569, Sec. 4, 45 Stat. 536; Nov. 30, 1945, c. 496, 59 Stat. 587."

These just quoted sections were Sections 2, 3 and 4 of the bill then under consideration.

On reading these three sections together, it becomes apparent what Congressman Reid meant when he said that the government shall be liable where it "diverts the water from the main channel." The intent was to provide compensation under such circumstances. There was no intent to deny anyone their rights under the Constitution. In 1928 negligence claims against the Federal Government were not recognized (except under "private" bills), and the entire discussion in the Congress centered around the rights of persons under the Fifth Amendment to the Constitution.

Congressman LaGuardia said:

> "There is no one who contends that property should be taken without compensation. There is no one who contends that property that is damaged by the work of the government should not be paid for . . ."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 7002.)

There was considerable discussion as to damages where "additional destructive flood waters" (Sec. 702d) were diverted from the main channel of the Mississippi River. Comments were made to the effect that there should not be compensation paid where water already "overflowed" in times of high water, as such place would be a "natural flood way" to which *Congressman Wilson* said:

> ". . . the fact that 300,000 cfs of water went through there does not justify the statement that there is a natural floodway whereby you can divert 700,000 to 900,000 cfs of water without any compensation for the damage it causes."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 7004.)

On this same point in the Senate discussions, *Senator Reid* said:

> "The United States will not now have to pay for flowage rights over lands now used in conducting the destructive water from the main Mississippi River. . . . If the work puts any additional flood destruction on those lands, that must be provided for."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 8122.)

Senator Wilson, in the course of an extensive discussion of the section here under consideration said:

> "The object and intention of Section 4 is that the government shall provide rights of way and construct protective works where the flood waters are to be diverted . . ."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 8211.)

From this Congressional History of the Mississippi Flood Control Act we conclude that Congress did not want to enlarge the rights of those who were damaged by floods, nor did the Congress wish to take away their rights. The Congress merely wanted the statute to reflect what it then believed the law to be as to the constitutional rights of persons damaged by floods.

As *Congressman Spearing* said, after specifically referring to the "flood or flood waters" clause:

> "While it is wise to insert that provision in the bill, *it is not necessary,* because the Supreme Court of the United States has decided . . . that the government is not liable for these damages." (Italics ours.)
>
> (Cong. Rec., 70th Cong., 1st Session, p. 7028.)

In other words, Congress did not want anyone to conclude that the federal government would be liable for damages from floods merely because it had embarked on a flood control program. We feel it significant that the "exemption" does *not* say no liability shall rest upon the United States for any damage due to the *flood control works.* It says no liability from or by "floods or flood waters". If Congress had meant to create an immunity on the part of the federal government as to damages resulting from the flood control project, how easy it would have been to have used the words "flood control works", or "flood control plan" as the first draft of the bill was worded.

It is a well recognized principle of statutory interpretation that a change in language during the con-

sideration of a bill by the Congress is a strong argument that the new language was not intended to mean the same as the former language. As the text reads in 50 *Am. Jur.* 332, Statutes, section 329:

> ". . . a change in the language of a bill during the course of its adoption, indicates an intention to enact a provision different in effect than that called for by the original language."

Here, the original language of the section referred to damage *"in carrying out the flood control plan"* whereas the amendment referred to damages *"from or by floods or flood waters."* Had the Congress intended to preclude any and all damage claims resulting, even in part, from the flood control project, they would have said:

> "No liability of any kind shall attach . . . for any damage in carrying out the flood control plan."

The Congress did not say there shall be no liability because of the *project,* but that there shall be no liability because of *floods.*

In 1928 there was considerable doubt whether, under the Constitution, the word "taken" included the word "damaged". Recent Supreme Court cases have clarified that point so that private property which is so damaged as to be destroyed is deemed "taken" under the Fifth Amendment. This is clear from the recent cases of *United States v. Chicago B & O Ry. Co.* (1936), 86 F. 2d 131; *United States v. General Motors* (1945), 323 U.S. 373, 89 L.Ed. 311; *United States v. Kansas City Life Ins. Co.* (1950),

339 U.S. 797, 94 L.Ed. 1277; also see annotation in 94 L.Ed. 1292.

There was considerable discussion on the floor of the House of Representatives when the "floods or flood waters" exemption was being considered as to whether "damaging" was included in the word "taken" in the Fifth Amendment. *Congressman Cox* argued extensively that under the cases of *Bedford v. U. S.* (1904), 192 U.S. 217; *Transportation Co. v. U. S.* (.....), 99 U.S. .....; *Mills v. U. S.* (.....), 46 Fed. 738, and *U. S. v. Lynath* (1903), 188 U.S. 445, no action would lie against the United States for "damaging" as distinct from "taking". (Cong. Rec., 70th Cong., 1st Session, pp. 7106-7107.)

To this proposition Congressmen Frear and Dempsey replied saying there should be recovery for "damaging".

Congressman Frear said:

> "Now, if there are no damages . . . that can be collected against the Government of the United States, I say they ought to have damages. . . . I am willing in subsequent legislation to give them an immediate right to show their damages in court."
>
> (Cong. Rec., 70th Cong., 1st Session, p. 7108.)

And *Congressman Dempsey* said:

> "Is there any doubt that if an amendment is needed to the law (to reimburse for actual damages) that the Congress will be ready to send him

to the courts to determine what actual damage he has sustained."

(Cong. Rec., 70th Cong., 1st Session, p. 7108.)

Here we have Congressional history support for the proposition that Congress did not intend to deprive persons of any right to redress for private property damaged for a public purpose, but an affirmative indication that if there was any question, the Congress would enact legislation to permit recovery for property damaged as a result of the flood-control project.

In 1928 there was no Federal Tort Claims Act, and there was no recognized cause of action for negligence against the federal government. Throughout the congressional debates in both Houses of Congress the term "negligence" was never used and the concept of negligence or tort was never alluded to. We have read every word in the Congressional Record relating to the 1928 flood control bill and make that statement flatly. Even the *original* language of section 4 was intended by the author of the bill to refer *only* to rights under eminent domain, as is evident from the remarks of *Senator Jones,* the sponsor of the bill, when he said:

". . . section 4 provides for just compensation, and is framed on the theory of the constitutional provision, that where property is taken for a public use it must be paid for."

(Cong. Rec., 70th Cong., 1st Session, p. 5487.)

When the Federal Tort Claims Act was under consideration in Congress, the question of liability for

damage resulting from negligence in connection with a flood control project was referred to repeatedly.

In Reports of the Committee on the Judiciary of both the Senate and the House of Representatives each report stated that there was an intent to preclude liability for flood damage "where no negligence is shown" in the enactment of the "discretionary function" exemption to the Federal Tort Claims Act. The only logical conclusion to this oft-repeated statement is that liability is recognized for flood damage *where negligence on the part of a government agent is shown.*

The Judiciary Reports referred to, *each* using the same language, said:

> "The first subsection of section 402 exempts from the bill claims based upon the performance or non-performance of discretionary functions or duties on the part of a Federal agency or Government employee, whether or not the discretion involved be abused, and claims based upon the act or omission of a Government employee exercising due care in the execution of a statute or regulation, whether or not valid. This is a highly important exception, intended to preclude any possibility that the bill might be construed to authorize suit for damages against the Government growing out of an authorized activity, *such as a flood-control or irrigation project, where no negligence on the part of any Government agent is shown,* and the only ground for suit is the contention that the same conduct by a private individual would be tortious, or that the statute or regulation authorizing the project was invalid."

The Reports containing the quoted language are:

1. House Report No. 2245, 77th Congress, 2nd session, June 16, 1942.

2. Senate Report No. 1196, 77th Congress, 2nd session, March 25, 1942.

3. House Report No. 1287, 79th Congress, 1st session, November 26, 1945.

From this review of congressional history we draw five conclusions:

1. There was no intention on the part of Congress to deprive any person of any right under the Fifth Amendment.

2. There was no intention on the part of Congress to deny, or to grant, any person any cause of action based on negligence. Negligence did not enter the "Stream of consciousness" of Congress because tort claims against the federal government were not recognized in 1928.

3. Section 702c was meant to make it clear that no claim for damage from or by a *natural* flood would be a basis of liability against the federal government.

4. Congress intended to recognize the right to compensation for damages resulting from "*additional destructive flood waters* that will pass by reason of *diversions from the main channel* of the Mississippi."

5. When Congress considered the Federal Tort Claims Act in the 1940's, it recognized that negligence on the part of a government agent on a flood control project would be compensable.

C. Case History of Section 702c.

1. Flood cases which specifically refer to Section 702c.

There are very few cases in the United States which have even mentioned Section 702c. In an effort to be sure that the Court has the benefit of every judicial comment relevant to this section, we here list every case known to us where Section 702c has even been mentioned:

a. *Clark v. U. S.* (D. C., Oregon, 1953) 109 F.S. 213;

b. *Clark v. U. S.* (1954) C.C.A. 9th, 218 F. 2d 446;

c. *Mid-Central Fish Co. v. U. S.* (D. C., 1953) 112 F.S. 792;

d. *Peerless Serum Co. v. U. S.* (D. C., Mo. 1953) 114 F.S. 662;

e. *National Mfg. Co. v. U. S.,* C.C.A. 8th, 210 F. 2d 263;

f. *Atkinson v. Merritt, Chapman & Scott* (D. C., Cal. 1954) 126 F.S. 406;

g. *Villareal v. U. S.* (1959) 177 F.S. 879;

h. *B. Amusement Co. v. U. S.* (1960) 180 F.S. 387.

We respectfully request that, if the United States Attorney discovers any additional cases in which Section 702c is even mentioned, such be brought to our attention so that we may review any such case or cases and present appropriate comment to the Court. We will here comment on each case we have listed above.

a. *Clark v. U. S.*, (D.C., Oregon, 1953) 109 F.S. 213.

This case involved a disaster caused, not by overtopping of levees, but by the failure of an embankment built by two railroad companies for the purpose of carrying trains and not for the purpose of flood protection. The United States had nothing to do either with the construction or the maintenance of the embankment which failed. The Court specifically found that "The United States owed no legal duty as regard plaintiffs in respect to flood waters". (109 F.S. 226.)

The charge against the United States was based entirely on the government seizure of the railroads in a labor dispute which the Court held was not sufficient to create a duty on the part of the government to maintain the embankment.

The trial Court also specifically said:

> "The cause of the failure of the dike has not been shown." (109 F.S. at 222.)

With this situation before it, the Court said (109 F.S. at 227):

> "[22-26] Although the Court has with great care examined the alleged bases of recovery against the government and has shown none exists, the Court holds there is an absolute defense available to the United States in the express language, 'No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place'. This act is valid, is applicable to the Columbia River, and

> was not repealed by the Tort Claims Act. It is inconceivable that the government could be held liable for acts done in a purely public capacity to forfend calamity. If a levee built by the government fails, is liability to be imputed? If the engineers change the course of flood waters from one bank to another to prevent the destruction of a city and the flood incidentally injures others, this act was to prevent liability. The United States for almost a century has supervised the works of the Mississippi Valley under protection of this doctrine. The shield has not been removed."

We have several comments with reference to the quoted portion of the Court's opinion. First, as the Court had already found that the United States had no duty to plaintiffs because it had no duty to maintain the embankment which broke, any reference to Section 702c was obiter dicta.

Second, the sentence,

> "It is inconceivable that the government could be held liable for acts done in a purely public capacity to forfend calamity."

indicated clearly a misconception by the trial Court of the scope of the Federal Tort Claims Act. This quoted sentence implies that the Federal Tort Claims Act did not create liability for purely governmental activities. This misconception was clarified by the Supreme Court in the two cases of *Indian Towing v. U. S.* (1955) 350 U.S. 61, 101 L. Ed. 48, in which the Supreme Court held the government liable for the negligent operation of a lighthouse and in *Rayonier*

v. U. S., (1957) 352 U.S. 215, 1 L. Ed. 2d 354, in which the Supreme Court held that the government would be liable for negligence on the part of the Forestry Service in fighting a forest fire. While the *Dalehite* case (1952) 346 U.S. 15, held that the Federal Tort Claims Act "did not change the normal rule that an alleged failure or carelessness of public firemen does not create private actionable rights", the Supreme Court in the *Rayonier* case held that the government is liable, under the Federal Tort Claims Act, for negligent firefighting, saying:

> "To the extent that there was anything to the contrary in the Dalehite case, it was necessarily rejected by Indian Towing. It may be that it is 'novel and unprecedented' to hold the United States accountable for the negligence of its firefighters, but the very purpose of the Tort Claims Act was to waive the government's traditional all-encompassing immunity from tort actions and to establish novel and unprecedented governmental liability." (1 L. Ed. 2d at 358.)

Firefighting constitutes "acts done in a purely public capacity to forfend calamity", and creates liability if done negligently. The quoted sentence from the *Clark* case is simply not the law, and the Court was in error.

Third, the next sentence,

> "If a levee built by the Government fails, is liability to be imputed?"

We say, "why not?" We translate this question thus —"if private property is damaged *because of,* not despite a government project, must just compensation

be paid?" The answer is, of course, it must! (Unless we repeal the Fifth Amendment.)

Judge Wiig, in the course of the hearing on the Motion to Dismiss in the case of *Stover v. U. S.*, asked:

> "Why should negligent flood control be exempt?"
> (Transcript of hearing on Motion to Dismiss, Stover v. U. S., No. 7483, 37:20-21.)

Fourth, the next sentence,

> "If the engineers change the course of flood waters from one bank to another to prevent the destruction of a city and the flood incidentally injures others, this act was to prevent liability."

while implying no liability, really implies (we say respectfully) that the Court had not read Section 702c, for this section *specifically* states that such damage *shall be compensable.* Should much weight be placed upon an interpretation of a code section by a Court which had not read the section?

Fifth, the next sentence,

> "The United States for almost a century has supervised the works in the Mississippi Valley under protection of this doctrine. The shield has not been removed."

should be answered by stating that the shield *has been removed.* The section (702c) was not enacted a century ago, but in 1928. The "shield" consisted of (1) a refusal of the Supreme Court to consider the destruction of property by a flood as "taken" within the Fifth Amendment phrase

"nor shall private property be taken for public use, without just compensation"

and (2) the doctrine of sovereign immunity. Damaging is now "taking" under the Fifth Amendment, and sovereign immunity has been eliminated by the Federal Tort Claims Act. The Court was in error—the shield has been removed.

b. *Clark v. U. S.,* (1954) C.C.A. 9th, 218 F. 2d 446.

This was the Court of Appeals opinion in the case we have just discussed. The Court of Appeals noted that the trial judge had specifically found as a fact that there was no negligence on the part of any defendant. Therefore, any reference to Section 702c was obiter dicta.

However, the Court said:

"[3-5] As to the liability of the United States because of the alleged negligence of the Engineers, we think a provision of 33 USCA Section 702c bars recovery. That section places certain conditions upon federal expenditures in aid of flood control and provides that: 'No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or by floods or flood waters at any place.' Appellants assert that this provision applies only to flood control aid on the Mississippi; however, supplemental acts authorizing expenditures on other rivers incorporate this provision. 33 USCA Section 701e. We find no merit in appellants' contention that the Tort Claims Act repealed this provision by implication. The provision of 33 USCA Section 702c

> barring liability 'from or by floods or flood waters' expresses a policy that any federal aid to the local authorities in charge of flood control shall be conditioned upon federal nonliability. To base recovery here on any act or omission of the Engineers in assisting in the fight against this flood would run counter to the policy thus expressed. See *National Mfg. Co. v. United States,* 8 Cir., 1954, 210 F. 2d 263, 270-275, certiorari denied, 347 U.S. 967, 74 S. Ct. 778."

We assert that there is nothing in Section 702c, or in the Flood Control Act, which justified the statement that federal aid is "conditioned upon federal non-liability." What does such a statement mean? Does it mean non-liability for inverse condemnation? Does it mean non-liability for negligence, at a time when there was no liability for negligence? There is nothing in the Congressional History to justify the statement that federal aid is conditioned upon federal non-liability. The "hold-harmless" clause was not enacted until 1936 (33 U.S.C.A. 701) and the Congressmen who passed Section 702c in 1928 repeatedly stated that just compensation should be paid. As we earlier quoted, *Congressman LaGuardia* said:

> "There is no one who contends that property that is damaged by the work of the government should not be paid for."

The fact that the Supreme Court denied certiorari should in no manner be construed as approval by the Supreme Court of any language in the opinion concerning Section 702c as the Trial Court and the Court

of Appeals both asserted that there was no negligence on the part of the United States.

c. *Mid-Central Fish Co. v. U. S.*, (D.C. Mo. 1953) 112 F.S. 792.

This case involved a "true" natural flood in which the flood water topped the levees. The damage occurred despite, not because of, the flood control project. The claim of negligence against the government was based upon a charge of negligent release of weather information—too little and too late. The Trial Court held that the Weather Bureau had no duty to the plaintiffs, and therefore, there was no liability.

But the Court did not stop there. On the strength of the now rejected *Dalehite* theory, the Court said that the Federal Tort Claims Act

> ". . . did not grant, or intend to grant, any new and novel causes of action enforceable against the Federal Government . . . but only waived immunity with reference to certain ascertainable tort claims under circumstances which in the past gave rise to specific private liability."
>
> (112 F.S. at page 795.)

These notions were specifically rejected by the Supreme Court in the *Indian Towing* and *Rayonier* cases, both supra.

Then the Court said:

> "[2] Furthermore, the Congress has specifically provided in the Flood Control Act, 33 U.S.C.A., Chap. 15, that 'no liability of any kind shall

> attach to or rest upon the United States for any damage from or by floods or flood waters at any place * * *.' Section 702c Title 33 U.S.C.A. In light of that Congressional mandate, we do not believe that liability can be predicated on the Government for flood damage by way of a tort claim, though negligence of a Government employee may have entered into the proximate cause of such damage."

Thus, after demonstrating a complete misunderstanding of the Federal Tort Claims Act, the Trial Court proceeded to demonstrate an equally complete misunderstanding of the meaning of Section 702c. What "Congressional mandate"? Section 702c does not say there shall be no liability for negligence in connection with a flood control project.

The entire opinion in the *Mid-Central Fish Co.* case reflects the perspective of the *Dalehite* case, a perspective which, time has shown, is all too limited. The Court erred in its interpretation both of the Federal Tort Claims Act and Section 702c.

d. *Peerless Serum Co. v. U.S.*, (D.C. Mo. 1953) 114 F.S. 662.

The same Judge who decided this case in the Trial Court decided the case just discussed, the *Mid-Central* case. The case arose out of the same flood—a flood which we concede was meant to be deemed a flood within the meaning of Section 702c. It was a *natural* flood, and the damage occurred *despite*, not because of, the flood control works.

The Court said:

"This is another of the numerous so-called 'flood cases' growing out of the Kaw River flood which reached its crest on July 13, 1951. The government has filed its usual motion for judgment on the pleadings, and counsel for the plaintiff have replied with brief wherein it is alleged that the averments of the complaint are different from those heretofore decided by the court.

An examination of the complaint and the authorities does not disclose such distinction.

It is but necessary to read the Flood Control Acts to obtain the proper inference that it was not the function of the government under all circumstances to furnish flood warnings to the public. Moreover, it must be repeated that, perforce the provisions of Section 702c, Title 33 USCA, the government specifically exempted itself from liability as follows:

'No liability of any kind shall attach to or rest upon the United Statess for any damage from or by floods or flood waters at any place.'

. . .

Moreover, it is clear that the Congress definitely exempted itself from liability in connection with navigation and navigable waters of the United States. It follows that the motion of the government should be sustained, And It Is So Ordered. . . ."

What is there in this Opinion to justify this case as authority for the proposition that Section 702c "specifically exempted itself from liability" in a case where the charge is that the Federal Government was

negligent in the planning, construction, maintenance, control, and operation of a flood control project? The United States declared it was not liable for damage from floods, but did not say it was not liable for damage caused by flood control projects. To have done so would have been unconstitutional.

e. *National Mfg. Co. v. U.S.*, (1954) C.C.A., 8th, 210 F. 2d 263.

This case was the appeal from the *Mid-Central* case, supra, the *Peerless Serum* case, supra, and several other similar cases which were consolidated on appeal. The case involved a natural flood which overtopped the levees, a "flood" within the meaning of Section 702c.

The Circuit Court of Appeals said:

> ". . . The language used shows Congressional anticipation that it will be claimed after the happening of floods that negligence of government employees was a proximate cause of damages where floods or flood waters have destroyed or damaged goods. But the section prohibits government liability of 'any kind' and at 'any place.' So that uniformly and throughout the country at any place where there is damage 'from' or 'by' a flood or flood waters in spite of and notwithstanding federal flood control works no liability of any kind may attach to or rest upon the United States therefor . . ."

If we confine the language in this case to the facts of the case, that is damage "from and by a natural flood," we do not have too great an objection to the

case. But if the language is meant to infer that Section 702c created an immunity on the part of the Federal Government for damage *because of*, not despite, the construction or maintenance of levees, we say such a construction is entirely unwarranted.

For example, may we refer to the sentence

> "But there is no question of the power and right of Congress to keep the government entirely free from liability when floods occur, notwithstanding the great government works undertaken to minimize them."

If this sentence means the Congress had the right to keep the government free from liability for damage which occurs *despite* the flood control works, we would agree. If the sentence be construed to mean that the Congress had the right to create governmental immunity for damage, which occurs *because* of the flood control works, we say such a statute would be unconstitutional as in violation of the Fifth Amendment which insures that no private property shall be destroyed by the government without just compensation.

That Congress was conscious of the constitutional limitations and obligations of the government is clear from the Congressional History of the 1928 flood control bill.

That section 702c means no liability where damage occurs despite, but not because of, flood control works is indicated in the sentence:

> ". . . where there is damage 'from' or by a flood or flood waters *in spite* of and *notwithstanding*

federal flood control works no liability of any kind may attach to or rest upon the United States therefor."

f. *Atkinson v. Merritt, Chapman & Scott,* (D.C. Cal. 1954) 126 F.S. 406.

"Upon careful consideration of the background of the quoted section, this Court is of the opinion that its purpose was to prevent the Government from being held liable for the staggering amount of damage *caused by natural floods, merely because* the Government had embarked upon a vast program of flood control. . . ."

and at page 409 the Court further stated:

"Thus the purpose of the enactment in question was to avoid a financial responsibility being placed on the Federal Government *for 'Act of God' disasters*, because of the enormous damage which results—often running into hundreds of millions of dollars. It seems plain that Congress did not intend to disclaim Federal liability *for water damage of every conceivable kind*, but rather to exempt the Government from liability for damage resulting *only from events that could properly be described as floods.* Liability in the case at bar turns in part upon a proper interpretation of the term 'floods or flood waters' found in Section 702c."

The statement that Section 702c was intended

". . . to prevent the government from being held liable for the staggering amount of damage caused by natural floods, merely because the government had embarked on a vast program of flood control. . . ."

is consistent with the statement in the *National Manufacturing* case, supra,

> ". . . where there is damage 'from' or 'by' a flood or flood waters in spite of and notwithstanding federal flood control works, no liability . . . shall attach to . . . the United States therefor."

Neither of these statements, nor the cases, say that there is no liability for damage from or by flood control works.

g. *Villareal v. U.S.* (1959) 177 F.S. 879.

This case involved a claim for damages resulting from waters from the Rio Grande diverted in a floodway system when the waters flowed over the spillways of a dam. The Trial Court held that Section 702c created an immunity from liability for flood damage, calling it a "statutory exemption."

The point raised in the case at bar was not really urged in the *Villareal* case, as plaintiffs did not contest the contention of the United States that Section 702c was an exemption statute, but merely argued that the exemption should not apply to the facts of the *Villareal* case. Therefore the *Villareal* case is not very strong authority as the key point was not contested.

h. *B. Amusement Company v. U.S.* (1960) 180 F.S. 387.

This case involves damages which occurred after an ice jam thawed on the Missouri River. The plaintiffs contended that the ice jam was caused by dikes

and revetments negligently placed in the river by the United States. The Trial Court found that the structures did not cause the ice jam.

The Trial Court did say that Section 702c was a "withdrawal of consent to be sued in such cases" (citing the case of *Grant v. TVA*, 49 F.S. 894 which was decided before the Federal Tort Claims Act became law) but this language must be read together with the language of the Court at page 390 when it said:

> "The United States has a constitutional right, even a duty, to improve navigation, and protect against floods for the benefit of all its citizens who are affected thereby. To say that, if it does enter into plans of improvement, it will stand liable for damages *regardless of negligence* would be an absurd rule, and contrary to the expressed will of Congress embodied in the provision quoted above, 33 USCA 702c." (Italics ours)

The substantial difference in the case at bar is that plaintiffs are not urging liability "regardless of negligence," but based upon negligence of the United States.

In fact, after careful review of all these cases, we feel that only one case holds that there is no liability upon the United States for damage *because of* flood control works constructed or maintained by the United States, and that single case *(Villareal)* was not really contested on that issue.

Now let us turn our attention to those cases which have held the United States liable for damage because of floods.

2. Flood cases which have recognized the liability of the United States for flood damage.

There are several cases which have either specifically held that the United States was liable for flood damage, or which have recognized that the United States may be liable.

a. *Atkinson v. Merritt, Chapman & Scott,* (D.C. Cal. 1954) 126 F.S. 406.

This case certainly recognizes that the United States may be liable for *creating* a flood. It is authority for the proposition that if the United States *causes* a flood, the government would be liable for damages. The case squarely held that the mere fact that there is flood damage does not bar liability, and the mere fact that there is damage "from or by floods or flood waters" does not bar liability. Under Section 702c there must be a natural flood and damage despite, not because of, flood control works. The project was a flood control project—the Folsom Dam.

b. *Desert Beach Corporation v. U.S.*, (S.D. Cal. 1955) 128 F.S. 581.

The government, in the course of the operation and maintenance of its canals, raised the level of a lake and flooded plaintiff's property causing damage. On page 585 the Court said:

> "[7] Finally, the Government contends that it has an absolute immunity in the case of irrigation and flood control operations. In support of this contention, the Government relies principally on *Atchley v. Tennessee Valley Authority*, D.C., 69 F. Supp. 952, and *Danner v. United States,*

D.C. 114 F. Supp. 477. An analysis of these cases indicates that the immunity found there was based on the fact that the acts of the Government were within the 'discretionary function' exemption. As previously developed, it may eventually be shown that plaintiff's damages are the result of discretionary function; however, if, as the complaint alleges, the damages of the plaintiff are the result of the negligence of an employee of the government, rather than the exercise of a discretionary function, then the Government is liable. While evidence might show that certain phases of the construction were within the discretionary function field, this would not relieve the Government from liability in the doing of other non-discretionary negligent acts in the carrying out of the project."

and in a footnote on page 585 the Court said:

"No contention is made that there is any specific statutory exclusion from liability. Compare 33 USCA 702c, Mississippi Flood Control Act."

Thus the Court, recognizing the existence of Section 702c, held that where the government causes a flood there is liability under the Federal Tort Claims Act even if the damage is "from or by floods or flood waters."

c. *Lauterback v. U.S.* (1951) 95 F.S. 470.

This case was a suit for damages under the Federal Tort Claims Act for damages sustained when plaintiff's property was washed away as the alleged result of the negligent operation of the Bonneville Dam. Section 702c was not mentioned by the Court. The

case was decided in favor of the defendant on the ground that no negligence was proven.

Thus we have a third case under the Federal Tort Claims Act where the Court recognized a cause of action for damages "from or by floods or flood waters" where the United States is maintaining and operating a flood control project—The Bonneville Dam.

d. *Ure v. U.S.* (Ore. 1950), 93 F.S. 770.

". . . Here the United States built and controlled a canal capable of carrying a volume of water far beyond the normal capacities of the local streams, under tremendous pressure, by virtue of the planned fall of the ditch. This construction further carried water high above the natural stream beds along the rimrock of the dusty hills. It is shown how the flow was carried by soil structures inept for such burden in this particular place. The United States, for its own purposes, retained complete direction and control of this artificial current. By its agents, the flow was wilfully directed through these structures, and the speed and volume of the column of water was built up, modulated or cut off completely. The parcels of realty of which Ure and others were seized geographically are lower and in positions exposed to the devastating rush of water if a break were to occur. These elements were obvious and the risk deliberately accepted by construction and especially by operation. The duty to protect rose with the danger.

"There is one suggestion made upon argument which must be rejected with scorn. It is said that, if the Government is held to responsibility for

> breaks in the canals and dams which it has constructed, it will effectually dampen the ardor of the bureaus for constructing other works. This suggestion is amoral at least."

Thus we have a fourth case under the Federal Tort Claims Act where the Court recognized liability on the part of the Federal Government in the maintenance and operation of public works despite the fact that the damage was "from or by floods or flood waters."

The fact that the *Ure* case just quoted was reversed by the Court of Appeals on the basis of the *Dalehite* case should not detract from the Trial Court's opinion, as this Court of Appeals (Ninth Circuit) was reversed in the *Rayonier* case in which the Supreme Court rejected the concepts expressed in the *Dalehite* case.

e. *Atchley v. TVA* (1947), 69 F.S. 952.

This was another case involving a flood control project and damage to crops destroyed by flood waters in which there was no mention of Section 702c. The TVA was charged with negligence in the control of flood waters which caused plaintiffs damage. The case was decided in favor of the defense, not because of immunity under Section 702c, not because there is no liability on the part of the government for negligence in the operation or maintenance of a flood control project, but because under the facts, the Court found that the conduct of the government which caused the damage was a discretionary function.

Thus we have a fifth case in which the Court recognized federal liability for flood damage where the United States is operating a flood control project—the TVA.

f. *Aycrigg v. U.S.* (N.D. 1952), No. 6299.

Plaintiffs sued under a private law enacted by Congress to recover damages for the flooding of their lands caused by negligence of the Corps of Engineers in negligently backfilling a cut in the levee. The flood occurred in 1937 and thus a private law was necessary, but the private law gave no greater cause of action than the Federal Tort Claims Act.

Section 702c was not mentioned by the Court as a possible defense. Judge Lemmon rendered judgment for the plaintiffs. This is a clear case of holding the federal government liable for negligence for damages because of the failure of a levee on the Feather River a few miles north of Marysville. And it occurred during the 1937 flood during which more water flowed down the Feather River than during the 1955 flood.

The *Aycrigg* case is "on all fours" with the case at bar, and therefore should be very persuasive in the case at bar.

The fact that Congress passed a private law for the *Aycrigg* case is powerful evidence that Congress does *not* have a policy of immunity from liability for damages occurring as a result of negligence of the government in the maintenance of a flood control project.

Thus we have a sixth case in which the Court recognized federal liability for flood damage where the

United States is operating a flood control project—the same levee system involved in the case at bar.

g. *Coates v. U.S.* (C.C.A. 8th), 181 F. 2d 816.

This case was an action under the Federal Tort Claims Act charging negligence on the part of the Federal Government in carrying out the 1928 Flood Control Act on the Missouri River. The complaint alleged:

> "6. Beginning in 1928 and progressing continuously thereafter certain agencies of the defendant entered upon a program of creating an avenue of waterway transportation over the Missouri River from Kansas City, Missouri, to St. Louis, Missouri, by substantially changing the flow, current, channel, banks and course of the Missouri River. Such effects were achieved by means of driving pilings, dredging channels, laying riprаps and employing mechanical and artificial devices."

The Court then said:

> "Then after alleging that the result of the government's actions was to change the nature of the annual spring rise of the river upon plaintiff's land from a gradual backing up and recession which left beneficial deposits of top soil thereon to a current which eroded and sanded the land and destroyed the crops."

The Court then ruled that the plaintiff's claim fell within the discretionary function exception to the Federal Tort Claims Act. In discussing this exception, the Court quoted from the records of Congress, saying:

"The Committee on the Judiciary of the House of Representatives in H. Rept. No. 1287 to accompany H.R. 181, an earlier bill containing the same provisions, 79th Congress, 1st Session, dated November 26, 1945, said of the 'discretionary function' exception (p. 5): 'The first subsection of section 402 exempts from the bill claims based upon the performance or non-performance of discretionary functions or duties on the part of a Federal agency or Government employee, whether or not the discretion involved be abused, and claims based upon the act or omission of a Government employee exercising due care in the execution of a statute or regulation, whether or not valid. This is a highly important exception, intended to preclude any possibility that the bill might be construed to authorize suit for damages against the Government growing out of an authorized activity, *such as a flood-control or irrigation project, where no negligence on the part of any Government agent is shown,* and the only ground for suit is the contention that the same conduct by a private individual would be tortious, or that the statute or regulation authorizing the project was invalid.''

We construe this quotation to imply that there is not absolute immunity in the construction or maintenance of a flood-control project, but that liability does lie if there is negligence in the construction, maintenance or operation of a federal flood-control project.

This apparently was the view of the Court in the *Coates* case as it continued its opinion, by quoting extensively from a law review article, saying:

"Commenting on the express mention of flood control in H. Rept. 1287, supra, p. 18, it is stated in 35 Georgetown L. J. 1, 42-43:

'The specific mention of flood control or irrigation projects as covered by the exception in Section 421(a) undoubtedly covers situations where approved flood-control activities of the Government, carried out in a *non-negligent manner,* imperil privately owned property or even where the United States, acting under the commerce clause of the Constitution, in the improvement of navigation causes mud and silt to settle on plaintiff's land in the bed of a formerly navigable tidewater creek, destroying the navigability thereof and depriving plaintiff of part of his fast land of accessibility to the creek in its natural and navigable state. Thus it is clear that the present act furnishes no basis of claim against the United States arising from such operations, carried out in a *non-negligent manner,* even though the same or similar activities by a private individual would be tortious. Surely it would be difficult to conceive of an activity more governmental in its inherent nature than flood control.

* * * * *

'Inasmuch as the United States is not to be held liable hereunder for direct damages of a *non-negligent character* occasioned in the carrying out of an authorized public project such as flood control or irrigation work; it would seem to follow as a logical sequitur that its long standing exemption from remote and consequential damages involving a taking in connection with such activity, or in fact consequential damages flowing from any taking incident to the non-neg-

> ligent performance of a public improvement should continue to be exempt from suit by virtue of Section 401 (a) of the Act.' "

That the Court fully recognized, and agreed that the federal government is liable for negligent construction or maintenance of a flood control project is made perfectly clear in the last paragraph of its opinion when it said:

> "It is argued for appellants that their complaint may be read as though it charged negligence in the changing of the river in respect to some mere job of work involved in carrying on the river project and not in the exercise of legislative and executive functions which sanction it and the performance of discretionary functions which control it. But the complaint presents no such charge and the court could not go outside the complaint to assume jurisdiction of a claim not stated in it. It had no jurisdiction of the claim stated and the order of dismissal is sustained."

Certainly when "the spring rise" came, plaintiff's land was "flooded" and this case says if there was negligence not in a category of a discretionary function there would be liability on the part of the United States.

This case is of real significance because it was the same court—the Court of Appeals, Eighth Circuit—which decided the *National Manufacturing* case, supra, and, we respectfully submit that our explanation of the *National Manufacturing* case is the only explanation which is consistent both with that case and the *Coates* case.

Thus we have a seventh case in which the Court recognized federal liability for flood damage where the United States is operating a flood-control project—the flood-control project built under the 1928 Flood-Control Act which enacted Section 702c.

h. *Olson v. U.S.* (1950), 93 F.S. 150.

This case involved an action under the Federal Tort Claims Act to recover damage to plaintiff's property when his land was flooded when the United States government opened the flood gates to a dam and released flood waters. The Court held for the defendant on the ground that this was a discretionary function. No mention was made of Section 702c, although the waters released were flood waters, as the Court said (at pages 152 and 153):

> "It is patent that in the control of the dam, the purpose of which was to hold back flood waters, the representatives of the United States must exercise discretionary functions. *When* flood waters are to be released and *how much* water is to be released certainly calls for the exercise of judgment; in other words, the performance of a discretionary function. . . .
>
> "Regardless of the use of the words 'negligent act', 'wilfully and intentionally' and 'lack of ordinary care and diligence', the complaint clearly indicates that the Government employees were engaged in the performance of discretionary functions or duties in the release or impounding of flood waters by use of the Lake Darling Dam. . . . The Government's agents did not open the gate in the dam in a negligent manner. They

merely abused their discretion as to *when* to open it."

The implication is clear that if the gate in the dam had been negligently opened, there would have been liability even though these were "flood waters" and the dam was a flood-control project.

Thus we have an eighth case in which the Court recognized federal liability for flood damage where the United States is operating a flood-control project.

D. THE MEANING OF SECTION 702c.

An "Act of the Elements" Defense.

The specific portion of Section 702c upon which the government relies for its defense reads:

> "No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place."

After reviewing the Congressional history of the 1928 Flood Control bill and the case history concerning federal liability for flood damages, we respectfully suggest that the quoted sentence means that the United States shall not be held liable for damage from or by *natural* floods or *natural* flood waters *simply* because the United States has undertaken the task of minimizing flood damage. It is an *"Act of the Elements"* defense.

Nothing else should be read into this Section of the Code.

It does not say the United States is not liable for damages from or by flood-control projects.

It does not say the United States is not liable for damages "due to the construction works", although this phrase is contained in the hold-harmless clause both in Section 701c and Section 702 A-12. Under rules of statutory construction, different phrases in the same chapter of the United States Code should be construed to have different meanings. Further, if Section 702c means there is no liability for damage due to the construction works, there is very little necessity for a hold-harmless clause in the Flood Control Act. We assert that there is liability under the Federal Tort Claims Act for damages "due to the construction works" and that the hold-harmless clause is an attempt to the extent that it can, for the federal government to shift such financial responsibility to the State.

The legal situation is similar to the situation in the case of *U. S. v. Sponenbarger* (1939), 84 L.Ed. 239 in which the Court said:

> "If major floods may sometime in the future overrun the river's banks *despite—not because of* —the government's best efforts, the government has not taken respondent's property. . . . The government has not subjected respondent's land to any additional flooding, above what would occur if the government had not acted." (Italics ours.)

Implicit in these words of the Supreme Court is that there would be liability if, *because of*—not despite—the government's best efforts, plaintiff's property had

been taken or destroyed. And now, under the Federal Tort Claims Act, if "because of" negligence of the government, property is destroyed, there is liability.

The language employed by the Court in the *National Manufacturing* case, supra, carried the same meaning when it said:

> ". . . where there is damage 'from or by' a flood or flood waters *in spite of and notwithstanding* federal flood control works, no liability of any kind may attach to or rest upon the United States."

Section 702c means if natural floods or natural flood waters cause damage despite—not because of—the government flood control works, the government is not liable.

Using the language of the *Sponenbarger* case, Section 702c means that *only* if the government has not subjected plaintiffs' property to any additional flooding above what would have occurred if the flood control project had not been built, the government will not be liable.

To constitute a defense under Section 702c (if it is a defense at all), defendant must prove that the damage to plaintiffs' property would have occurred if the flood control project had not been built.

The general rule with reference to "Act of God" defenses is that the Act of God must be the sole cause of the damage, and that if any act of man combines with an Act of God, there is liability on the negligent man.

In other words, an Act of God does not excuse negligence. The Act of God, to be a defense, must be the *sole* proximate cause of the damage.

Viewing the defense from another angle, the "defense" of Act of God simply means that the defendant was not negligent, or otherwise guilty of liability-creating conduct.

That this is the rule is clear from the case law. The general statement in 169 A.L.R. 533 says:

> "It is general rule that it is a defense to an action for damages from escaping waters . . . that the escape of the waters was caused wholly by an Act of God."

We have found no United States Supreme Court case which states this rule, but in the case of *Inland Power & Light Company v. Grieger* (1937) (Ninth Circuit) 91 F. 2d 811, 112 A.L.R. 1075, the Court said:

> ". . . where damage is the result of two concurring causes, one of which is the negligence of defendant and the other the negligence of a third person the defendant is liable to the same extent as though it had been caused by his negligence alone." . . .
>
> "Is there any different rule where the concurring causes of the damage are an act of God and negligence of the defendant? By the overwhelming weight of authority the rule is the same."

In the *Inland Power* case the Court held the defendant liable for all the damage from the flood in a case where the defendant's negligence only caused six per cent of the water to flow on plaintiff's land.

The general rule is stated in 38 *Am. Jur.* 719, Negligence, Sec. 65 "Natural Forces or Conditions; Act of God or Inevitable Accident":

> "The general rule is that when the negligence of a responsible person concurs with an ordinary flood, storm, or other natural force, or with a so-called act of God, in producing an injury, the party guilty of such negligence will be held liable for the injurious consequences, if the injury would not have happened except for his failure to exercise care."

If an "Act of God" is the sole cause of damage, the defendant would prevail, not because he proved an Act of God, but because the plaintiff failed to prove the defendant's conduct was a contributing proximate cause of the damage. The principle is the same as the so-called "unavoidable accident" defense, which is not a defense at all, but merely a situation in which the plaintiff fails to prove actionable conduct on the part of the defendant proximately contributing to plaintiff's injury. Just as there is no such thing as a "defense" of unavoidable accident, there is no such thing as a "defense" of Act of God.

See,

Butigan v. Yellow Cab Co. (1958), 49 Cal. 2d 652, 320 P. 2d 500.

E. CONSTITUTIONALITY OF SECTION 702c.

Only if the Court disagrees with the proposition that Section 702c is not an immunity statute does it

become necessary to consider the constitutionality of Section 702c.

If Section 702c be construed to create immunity from negligent conduct on the part of the federal government, we respectfully submit that Section 702c is unconstitutional.

Can a governmental body create its own immunity? A private person cannot. In a nation of free men, we respectfully submit, neither can the government.

"Sovereign" immunity it is called. Sovereign? Who has sovereignty in the United States of America? While it is proper to speak of the government as sovereign when considering the relations between governments, when we consider the relationship between the people and *their* government, are not the people sovereign?

Are not the people the masters, and the government the servant of the people? Should the servant be able to create its own immunity as against its master? Is it not just as incongruous as my creating my own immunity?

Several state Supreme Courts have recently rejected the concept of sovereign immunity and declared that under the Common Law sovereign immunity never did exist.

Muskopf v. Corning Hospital District, 55 Cal. 2d 211, 359 P. 2d 457;

Molitor v. Kaneland Community Dist., 18 Ill. 2d 11, 163 NE 2d 89;

Colorado Racing Comm. v. Brush Racing Assn., 136 Colo. 279, 316 P. 2d 582;

Hargrove v. Town of Cocoa Beach (Fla.), 96 So. 2d 130;

Williams v. City of Detroit, 364 Mich. 231, 111 N.W. 2d 1;

Holytz v. City of Milwaukee, 17 Wisc. 2d 26, 115 N.W. 2d 618;

Spanel v. Mounds View School Dist., Minnesota Supreme Court, #38513, December 14, 1962.

A reading of the famed case of *Chisholm v. Georgia,* (1793) 2 U.S. 16 reveals a philosophy directly contrary to sovereign immunity as the case utterly rejects the idea that the government is superior to the individual and reflects equality of the individual with the government; it rejects the idea of men's rights being derived from the government but asserts that the rights of the government come only from the people; it rejects the concept that the government must give its consent to be sued; it rejects the concept of sovereign immunity in a nation of free men.

We respectfully submit that sovereign immunity does not exist.

We respectfully submit that the people have a basic, inalienable right to sue their servant, the government.

Repeatedly, it has been held, and we think correctly, that a right cannot be destroyed by the legislature unless a reasonable substitute is provided. This principle has been held in the following cases:

Stewart v. Honk (Oregon), 271 Pac. 998;

Coleman v. Rhodes (Delaware) 159 Atl. 649;

Ludwig v. Johnson (Ky.) 49 S.W. 2d 347;

Heck v. Schupp (Illinois), 68 N.E. 2d 464;

Noel v. Meninger Foundation (Kan.), 267 P. 2d 934;
Lebohm v. Galveston (Tex.), 275 S.W. 2d 951;
New York Central Ry. v. White, 243 U.S. 188, 61 L. Ed. 677.

That the government cannot create its own immunity is implicit in the cases of:

Wren v. Corsicana (Tex. 1958), 309 S.W. 2d 102;
Suwannee Hospital v. Golden (Fla. 1952), 56 So. 2d 911;
Ettor v. City of Tacoma (1913), 228 U.S. 148;
Gulf Transit Co. v. U.S. (1908), 43 Ct. Cl. 183.

Any attempt to create immunity on the part of the government would be unconstitutional as a denial of due process under the principles of these just cited cases.

The tottering doctrine of sovereign immunity has been under attack in the Supreme Court of the United States for a number of years. In 1938 Justice Frankfurter described the doctrine as "legal irresponsibility" (*Keifer v. RFC,* 306 U.S. 389, 83 L. Ed. 784 at 788, and in 1954 in the case of *National City Bank v. Republic of China,* 348 U.S. 357, 99 L. Ed. 389 he said:

> "But even the immunity enjoyed by the United States as a territorial sovereign is a legal doctrine which has not been favored by the test of time. It has increasingly been found to be in conflict with the growing subjection of governmental action to the moral judgment."

As Justice Brennan said in his dissenting opinion in the case of *Barr v. Matteo* (1959), 360 U.S. 564, 3 L. Ed. 2d 1434:

> ". . . the courts should be wary of any agreement based on the fear that subjecting government officers to the nuisance of litigation and the uncertainties of its outcome may put an undue burden on the conduct of business. Such a burden is hardly one peculiar to public officers; citizens generally go through life subject to the risk that they may, though in the right, be subject to litigation and the possibility of a miscarriage of justice.
>
> . . .
>
> but the way to minimize the burdens of litigation does not generally lie through the abolition of a right to redress for an admitted wrong. The method has too much of a flavor of throwing out the baby with the bath. . . ."

Chief Justice Warren said in his dissent in the same case:

> "The principal opinion in this case . . . has not given even the slightest consideration to the interest of the individual. . . . It is a complete annihilation of his interest."

Justice Douglas and Justice Harlan, dissenting in the case of *Malone v Bowdoin* (1962), 8 L. Ed. 2d 168 at 174 said:

> "Sovereign immunity has become more and more out of date, as the powers of the government and its vast bureaucracy have increased."

Concepts which are basically unfair eventually fade, wither, and die. Are not these words of Chief Justice Warren and Justices Douglas, Harlan, and Brennan the soft chant in the background of the requiem of the doctrine of sovereign immunity whose demise has occurred and should now be announced?

We respectfully submit that if sovereign immunity does not exist as a part of the Common Law, the government has no constitutional power to create its own immunity as against its sovereign masters—the people of the United States.

V

CONCLUSION

The government built a container to hold all the water which drained out of the Feather River watershed. The government knew that it could not control the amount of water which would flow into the container, and it left a natural spillway at Hamilton Bend. Water in excess of the capacity of the container could not drain into the container. Four times in fifty years more water than the container could hold drained out of the watershed but the natural spillway at Hamilton Bend prevented water in excess of the capacity of the container to enter the container. In 1955 the government closed the natural spillway at Hamilton Bend and the inevitable happened—water in excess of the capacity of the container drained into and burst the container.

We respectfully submit that Congress, in its wisdom, did not intend that innocent victims of such preposterous conduct should bear the full financial burden of the Government's misconduct.

Under the Trial Court's interpretation of Section 702c the government would not be liable if the Folsom Dam collapsed, even if inadequate cement had been used, because the damage to the plaintiff was "from or by floods or flood waters."

Under the Trial Court's interpretation of Section 702c the government would not be liable even if a section of the levee had been made of "papier mache" because the damage to plaintiffs was "from or by floods or flood waters."

We respectfully submit that the reasonable interpretation of Section 702c is that the government is not liable for damage which occurs "despite" flood control works, but that Congress did not intend to immunize the United States from liability "because of" flood control works.

Dated, February 20, 1963.

Respectfully submitted,
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Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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Attorney for Appellants.

No. 18,275

IN THE

United States Court of Appeals

For the Ninth Circuit

RAYMOND L. STOVER, et al.,
Appellants,

v.

UNITED STATES OF AMERICA,
Appellee.

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SUBJECT INDEX

(Table of Authorities on next page)

TABLE OF AUTHORITIES

Cases

Statutes

Congressional Record and Reports

(Index to Appendix on next page)

APPENDIX

Page

No. 18,275

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United States of America,
Appellee.

BRIEF FOR THE APPELLEE

I. JURISDICTIONAL STATEMENT

The jurisdiction of the Trial Court was based on the Federal Tort Claims Act (Title 28, U.S. Code, Section 1346(b) et seq.).

The jurisdiction of this Court on appeal from the decision of the Trial Court—which is reported at 204 F. Supp. 477 (1962)—is based on Title 28, U.S. Code, Sections 1291 and 1294.

II. STATEMENT OF THE CASE

The one issue before the Trial Court was whether the affirmative defense of the appellee under the portion of Section 702c, Title 33, U.S. Code, reading:

> "No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place. . . ."

exempted it from liability to the appellants in these consolidated cases. After receiving evidence as to the facts, hearing argument as to the law, and considering the memoranda of the respective parties, the Trial Court held, *inter alia,* that:

> (1) The waters which had inundated the appellants' lands were part of a flood within the meaning of the terms "floods or flood waters" as used in said statute; and
>
> (2) Section 702*c* therefore provided the United States a complete legal defense to the actions. (Clerk's Transcript of Record, Conclusion No. 7, p. 77; Nos. 8 and 9, p. 37; 204 F. Supp. 477, at 485.)

The Trial Court ordered that judgment be entered accordingly in favor of the United States of America. The present appeal followed in due course.

In their "Statement of the Case," the appellants set forth a number of factual and procedural matters and contentions as to certain rulings of the Trial Court. These will be discussed separately under the following subheadings:

A. As to the Facts

The appellants state some of the pertinent facts from the decision of the Court below (Op. Br., pp. 2-7). They omit, however, certain other pertinent facts which show the magnitude of the rainfall and streamflow in the Feather River basin during the critical month of De-

cember 1955. For a full understanding of all of the facts which are pertinent to the legal issues here involved, the entire portion of the Trial Court decision under the heading "I—The Facts" should be considered (Cl. Tr., pp. 64-68; 80-81; 204 F. Supp. 477, at 478-481). The following excerpt therefrom is particularly important:

> "A comparison of the precipitation received in December, 1955, with that recorded over the previous 50 years at specified locations within the Feather River basin indicates the abnormal extent of rainfall which preceded the inundations.[4] During the period of *one week* preceding the levee breaks, the Feather River basin received nearly 200% of the *monthly* normal precipitation (This in a month that is regularly rainy).[5] This deluge arrived at a time when the ground was still saturated from the storms of earlier in the month, which meant that the amount of water run-off would be greatly increased as the capacity of the ground for water absorption decreased.
>
> "Turning away from a comparison with prior averages and norms, and looking to previous specific

"[4] It is important to note that the Nicolaus break occurred on December 23 shortly after noon, and that the Gum Tree break followed at approximately 12:10 a.m. on December 24. The record does not indicate the precise time at which the Western Pacific Interceptor Canal breaks occurred. With these dates in mind, the following precipitation figures indicate the extent of rainfall occurring which could have been involved in, and connected with, the breaks.

Drainage Area	Rainfall during specified times of the month			Monthly Normal
	1st-22nd	15th-22nd	23rd	
Feather River	19.57	14.60	2.77	7.95
Yuba River	24.91	17.59	4.66	9.57
Bear River	18.24	12.45	3.40	7.37"

"[5] Considering the fact that the Feather River basin is a heavy rainfall belt, it is noteworthy that the amount of precipitation received in that area during the two-week period of December 15–28 ranged from 40% to 65% of normal *for the entire year.*"

weather conditions which had caused floods, the month of December, 1955, appears as a singularly extraordinary period of weather phenomena. The records of the 16 rain-gauging stations with records extending back at least to 1915 were received in evidence, with a tabulation of the 'maximum annual five consecutive day precipitation amounts' indicated. Of these 16 stations, the five consecutive day maximum precipitation amounts in December, 1955 (the particular period involved was, in most cases, December 19 through December 23[6]), were the highest of record at 10 stations, the second highest at 4 stations, the third highest at 1 station, and the fourth highest at 1 station. At the stations where December, 1955, was not the highest of record, there was no other single year in which the maximum for those stations coincided during the same storm period.[7]

"In addition to the extraordinary precipitation which took place during the month of December, 1955, and connected therewith, was the magnitude of the streamflow emerging from the mountains and foothills onto the valley floor. The readings of three of the stream-gauging stations which recorded the flow are particularly significant, since they are located at the foothill line of the streams that flow into the lower basin, rather than up in the watershed, and are relatively unaffected by the upstream works of man.[8]

"[6] From December 19 through December 23, the average precipitation measured in inches at the gauging stations throughout the basin amounted to 15.41 for the Feather River drainage area, 20.31 for the Yuba River drainage area, and 14.39 for the Bear River drainage area. One station registered, in a five-day period, 27.49 inches of precipitation, more than 8 inches over the preceding high."

"[7] Most of the preceding maximums occurred at times which have generally been accepted as the times of previous 'floods.' The most common periods of previous highs were November, 1950; February, 1940; and December, 1929."

"[8] The selected gauging stations are located on the Feather River near Oroville, on the Yuba River at Englebright Dam, and on the Bear River near Wheatland."

"During the month of December, 1955, the stream flow of the Feather River, at the gauging station near Oroville, increased from a rate of approximately 5,000 c.f.s. (cubic feet per second) at the beginning of the month, through successively higher peaks which culminated in a peak flow of 203,000 c.f.s. on December 23. Similar increases in stream flow occurred on the Yuba River (peaking at 148,000 c.f.s. on December 23) and the Bear River (peaking at 33,000 c.f.s. on December 22). These flows were the maximum, or near the maximum, of record. The Feather River near Oroville had the second highest peak during the 59 years of record.[9] On the Yuba River, the flood peak was some 40% higher than had occurred during the 57 years of record prior to December, 1955. On the Bear River, the flood peak was the highest in 56 years of record.

"Correlative with the recordings of streamflow are the records of the river stage levels during this period. Similar findings attend a reading of such records. In each case, the stage level at the gauging stations of the Feather, Yuba and Bear Rivers, and their tributaries, were either at or near the highest which had been recorded.[10]

"Although the most definitive studies were made at the three above-mentioned gauging stations, simi-

[9] On March 19, 1907, during the floods of that year, the discharge rate at the Oroville gauging station was 230,000 c.f.s."

[10] The following river stage readings were taken during the events here involved, and compare with previous recordings at the same stations. These readings are indicative, but not exhaustive, of the readings at all the stations throughout the basin.

River and Gauging Station	December, 1955 Reading	Previous Maximum
Feather River near Oroville	76.77	73.6 (Dec., 1937)
Feather River at Nicolaus	51.60	47.80 (Nov., 1950)
Yuba River at Englebright Dam	17.73	14.69 (Nov., 1950)
Yuba River at Marysville	82.5	71.27 (Nov., 1950)
Bear River near Wheatland	19.30	20.83 (Nov., 1950)"

lar results were noted at all of the gauging stations in the lower Feather River basin."

The text and footnotes of the Trial Court show with precise facts and statistics from the record that the rainfall, the resulting streamflow, and the various river stages in the Feather River basin were meteorological and hydrological events of enormous magnitude—the largest in over a half century of record at most locations. Of particular significance is footnote 10 showing, among others, the streamflow at the three foothill gauging stations mentioned in footnote 8, since those stations are situated at or shortly upstream from the points where the rivers emerged from the Sierra and entered the levee system of the Sacramento River Flood Control Project. The flow records at those stations show that the flows of water at each were of such a high order of magnitude that a flood occurred by any reasonable definition of the term and irrespective of the entry of the water into the levee system.[1] It is essential that these facts—which the appellants do not contest—be fully recognized in considering the issues which the appellants raise in their Opening Brief and our discussion thereof in the following portions of this Brief for the Appellee.

B. As to Procedure

The appellants refer to various procedural steps in the trial—but omit mention of the discovery and pretrial proceedings through which the consolidated actions were developed and the affirmative defense of the appel-

[1] The findings of fact by the Trial Court (Cl. Tr., p. 76 and 36-37; 204 F. Supp. 477, at 484-485)" are derived directly from the evidence presented by the appellee at trial. For further reference, see the Topical Index of Evidence in the Appendix hereto.

lee under Section 702c, Title 33, U.S. Code, was separated for trial and determination in advance of other issues. These important details—showing the full presentation on behalf of the respective parties and thorough consideration by the Trial Court—were stated in the Pre-Trial Order which was entered on November 21, 1961 (Cl. Tr. pp. 92-103) and referred to in the final decision at pages 478, 482, and 484 of 204 F. Supp.[2]

The appellants also omit mention of their application of November 30, 1961 to this Court for permission to appeal from the Pre-Trial Order under Title 28, U.S. Code, Section 1292(b). In that application, the appellants presented the same arguments they had made to the Trial Court and are again making here as to the affirmative defense of the appellee under Section 702c (Docket No. 17658 in this Court). In that application, the appellants contended, *inter alia,* that the decision of this Court in *Clark v. United States,* 218 F.2d 446 (1954), upon which the Pre-Trial Order was expressly based, was erroneous and inapplicable to these consolidated cases. While the denial of the application was made without comment by this Court, it is significant in view of the appellants' challenge to the decision in *Clark.*

Throughout their Statement of the Case and in subsequent portions of their Opening Brief, the appellants criticize various rulings made by the Trial Court during the pre-trial and trial proceedings. We not only disagree with such criticism, but also point out that it disregards the final paragraph of the decision below under "I—The Law," wherein the Court observed:

[2] Compare proceedings in *Clark* v. *United States,* 13 F.R.D. 342 and 109 F.Supp. 213 (1952), noted by this Court in its decision on appeal—218 F.2d 446, at 448 (1954).

> "There well may be some statements in the record of this case which appear to be, or in fact actually are, inconsistent with the position which I now take. If such there be, they are not to be taken as being final expression of my views. My final views are expressed in this memorandum." (Cl. Tr. pp. 75-76; 204 F. Supp. 477, at 484.)

In the light of this statement by the Trial Court, the criticism by the appellants is clearly unwarranted and need not be considered herein.

C. As to Contentions

At the conclusion of their Statement of the Case, the appellants concede that there was a flood in the Feather River basin in December 1955 which caused the damages for which they seek to recover from the appellee (Op. Br., pp. 6-7). The appellants then contend, however, that the key point of the case is not whether there was a flood but whether that flood was natural or "man-made." The mistake in this contention is clearly shown by the facts of record, upon which the decision below was based. There was certainly no element of "man-made" flood in the events of December 1955 which are here involved. To interpose the concept of "man-made" into those events is an obvious contrivance. In one way or another, all activities attributable to the United States in a tort claim action necessarily involve some activities of man. Any attempt to categorize the flood which is here involved as "man-made" or "non-man-made" is simply diversionary and not determinative of the meaning and applicability of the portion of Section 702c, Title 33, U.S. Code, upon which the affirmative defense of the appellee herein depends.

In contrast, the appellee contends—on the bases of the decisions in the *Clark* case, *supra*, and *National Mfg. Co.* v. *United States,* 210 F.2d 263 (1954), certiorari denied 347 U.S. 967 (1954)—that the issue to be resolved in the present litigation is not whether any activities of man or of the United States were involved in the events which occurred in the Feather River basin in December 1955, but whether the waters therein were floods or flood waters within the meaning of said portion of Section 702c. As the decision of the Trial Court clearly shows under "I—The Facts," *supra*, those waters were floods or flood waters by any concept or definition when they emerged from the Sierra and became confined within the levee system of the Sacramento River Flood Control Project. Certainly they did not thereafter change or lose their character as floods or flood waters, nor bar the affirmative defense of the appellee under the provisions of Section 702c, Title 33, U.S. Code.

III. SPECIFICATION OF ERRORS

Under this heading, the appellants assert various "errors" of the Trial Court upon which they purportedly rely on appeal, and comment and argue thereon. In the succeeding section entitled "IV—Argument," the appellants assert an apparently different ground as their "basic contention" and confine their argument thereto, without reference the "errors" previously asserted in "III—Specifications of Errors." To avoid confusion, the several contentions will here be discussed in the order in which they appear under the respective headings in the appellants' Opening Brief.

A. The appellants first assert that the Trial Court erred in holding Title 33, U.S. Code, Section 702c, to

be an immunity statute (Op. Br., pp. 7-12). This assertion not only mis-states the holding of the Trial Court, but misconceives the nature of Section 702c as defined by this Court in *Clark, supra,* and by the Eighth Circuit in *National Mfg., supra.*

In *Clark,* this Court stated at page 452 of 218 F.2d:

> ". . . The provision of 33 U.S.C.A. § 702c barring liability 'from or by floods or flood waters' expresses a policy that any federal aid to the local authorities in charge of flood control shall be conditioned upon federal non-liability. To base recovery here on any act or omission of the Engineers in assisting in the fight against this flood would run counter to the policy thus expressed. See *National Mfg. Co.* v. *United States,* 8 Cir., 1954, 210 F.2d 263, 270-275, certiorari denied, 347 U.S. 967, 74 S.Ct. 778."

In *National Mfg.,* the Eighth Circuit stated at pages 270-271 of 210 F.2d:

> "1. The bar of Section 3 of the 1928 Act. [Sec. 702c, Title 33, U.S. Code.]
>
> "The 1928 flood control Act authorizing appropriations in excess of $300,000,000 for flood control work on the Mississippi River provided for the preparation and submission to Congress of 'projects for flood control on all tributary streams of the Mississippi River system subject to destructive floods' including 'the Missouri River and tributaries.' 33 U.S.C.A. § 702j. In the later Flood Control Act of June 22, 1936, 49 Stat. 1570, 1588, Congress 'adopted and authorized to be prosecuted' as 'works of improvement, for the benefit of navigation and the control of destructive flood waters and other purposes' hundreds of flood control projects

in all parts of the country including 'levees and flood walls to protect people and city property' and 'Kansas Citys on Missouri and Kansas Rivers in Missouri and Kansas.' Congress also affirmed the application to the 1936 Act of the general provisions of the 1928 Act including Section 3 by providing, Sec. 8, that:

> " 'Nothing in this Act shall be construed as repealing or amending any provision of the Act entitled "An Act for the control of floods on the Mississippi River and its tributaries, and for other purposes," approved May 15, 1928, or any provision of any law amendatory thereof.' 33 U.S.C.A. § 701e.

[1] Thus it appears on inspection of the two flood control Acts referred to that when Congress entered upon flood control on the great scale contemplated by the Acts it safeguarded the United States against liability of any kind for damage from or by floods or flood waters in the broadest and most emphatic language. The cost of the flood control works itself would inevitably be very great and Congress plainly manifested its will that those costs should not have the flood damages that will inevitably recur added to them. Undoubtedly floods which have traditionally been deemed 'Acts of God' wreak the greatest property destruction of all natural catastrophies and where floods occur after flood control work has been done and relied on the damages are vastly increased. But there is no question of the power and right of Congress to keep the government entirely free from liability when floods occur, notwithstanding the great government works undertaken to minimize them. Congress included Section 3 in the 1928 Act and carried it forward

into the 1936 Act and others with intent to exercise that power completely and to absolutely bar any such federal liability.

"It was not indicated in the 1928 Act that Congress expected to carry on the federal flood control projects without imposing upon the United States certain obligations to affected owners of property. The constitutional prohibition against the taking of private property for public use without just compensation was kept in view, U. S. v. Sponenbarger, 308 U.S. 256, 60 S.Ct. 225, 84 L.Ed. 230, and provision for compensation to be paid to landowners in certain circumstances is contained in the same section 3 which prohibits any federal liability for damage from or by floods or flood waters. [Footnote quoting Section 702c omitted.] The Federal Tort Claims Act of August 2, 1946, had not been passed in 1928 or 1936 and the government then had a certain sovereign immunity from suit for torts but when Section 3 is read in its context it is clear Congress meant by it that damages from or by floods or flood waters should not afford any basis of liability against the United States regardless of whether the sovereign immunity was availed of or not. The declaration of Section 3 negates the existence of a cause of action against the United States in the situation covered by it.

"Undoubtedly that absolute freedom of the government from liability for flood damages is and has been a factor of the greatest importance in the extent to which Congress has been and is willing to make appropriations for flood control and to engage in costly undertakings to reduce flood damages."

The following excerpt from the separate concurring

opinion of Circuit Judge Johnsen in *National Mfg.* should also be noted in this regard:

> "To me, there are two fundamental grounds of non-liability here, and I would avoid any possible weakening of their emphasis by the discussion of other contentions.
>
> "The first is the absolute policy which Congress has expressly declared, that 'No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place.' 33 U.S.C.A. § 702c. This unmistakable and long-established policy can not soundly be regarded, I think, as having been repealed by implication, in the enactment of the Federal Tort Claims Act, 28 U.S.C.A. §§ 1346, 2671 et seq., on the basis of any surrendering indication in either the Act's general language or its legislative history. But this ground is fully covered in the court's opinion, and I shall not discuss it further." (P. 279 of 210 F.2d.)

From the foregoing, it is clear that the portion of Section 702c on which the affirmative defense of the appellee depends is not based on sovereign immunity, but is a Congressional declaration of the long-established public policy of non-liability upon which Federal participation in flood control work has always been conditioned.[3]

There is nothing in the present record or in the appellants' contentions to warrant modification or reversal of the decisions in *Clark* or *National Mfg.* or any of the prior decisions cited therein. Accordingly, the decision here on appeal—which was based primarily on *Clark* and *National Mfg.*—should not be disturbed.

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[3] For further background, see also: Pp. 108-111 of the USA's Brief to this Court in *Clark*, and pp. 20-21 of the USA's Brief to the Eighth Circuit in *National Mfg.*, which are included in the Appendix and discussed hereinafter.

B. The appellants' next assert that the Trial Court erred in holding that proximate cause was not an issue in these consolidated cases (Op. Br., pp. 12-15). In support of the assertion, the appellants quote at page 15, a paragraph from the decision below (Cl. Tr., pp. 71-72; 204 F. Supp. 477, at 482-483). The quoted paragraph is based upon the decision in *National Mfg., supra,* wherein the Eighth Circuit stated in pertinent part:

> "The plaintiffs in these actions argue that negligence of government employees was a proximate cause of their damages but they include in their complaints that the damages involved resulted from the fact their goods, wares, and merchandise 'were flooded and inundated by the waters and oil, mud, muck, and debris carried therewith and * * * were damaged, ruined, and destroyed' (National's complaint). In the Shipley Company's complaint it is alleged that 'the said Kaw river' 'flooded the said Central Industrial District and destroyed and damaged the personal property of the plaintiff.' Some such allegations are necessary to present the cases. But it is in just such a situation that the language of Section 3 plainly bars recovery against the United States. The section does not limit the bar against such recovery to cases where floods or flood waters are the sole cause of damages. It does bar liability of any kind from damages 'by' floods or flood waters but it goes further and in addition it bars liability for damages that result (even indirectly) 'from' floods. The use of the word 'from' in addition to 'by' makes it clear that the bar against federal liability for damages is made to apply wherever floods or flood waters have been substantial and material factors in destroying or damaging

property. The language used shows Congressional anticipation that it will be claimed after the happening of floods that neligence of government employees was a proximate cause of damages where floods or flood waters have destroyed or damaged goods. But the section prohibits government liability of 'any kind' and at 'any place.' So that uniformly and throughout the country at any place where there is damage 'from' or 'by' a flood or flood waters in spite of and notwithstanding federal flood control works no liability of any kind may attach to or rest upon the United States therefor." (210 F.2d 263, at 271.)

As noted above, the Supreme Court denied certiorari in *National Mfg.* at 347 U.S. 967.[4]

We submit accordingly that the holdings of both the Trial Court herein and the Eighth Circuit in *National Mfg.* on the question of proximate cause are correct and should not be disturbed by this Court.

C. Thirdly, the appellants assert that the Trial Court erred in refusing to receive any evidence on the issue of whether the flood here in question was a "man-made" flood (Op. Br., pp. 16-25). This assertion is apparently based on the distinction between natural and "man-made" floods first suggested in *Atkinson v. Merritt, Chapman, & Scott Corp. et al.*, 126 F. Supp. 406 (N.D. Calif. 1954) which is discussed below at pages 22-23 of this brief.

The appellants particularly complain that their offers of proof on such issue were denied by the Trial Court.

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[4] For further background, see the excerpts from pages 19-20 of the USA Brief to the Eighth Circuit in *National Mfg.*, which are included in the Appendix hereto.

The appellants cite no reasons or authorities in support of such offers—nor could they properly, in view of the decisions of this Court in *Clark,* and the Eighth Circuit in *National Mfg.,* set forth above, especially the concluding sentences in each.

Moreover, the evidentiary value of most of the appellants' offers of proof is seriously questionable—even assuming such offers could be proved—since the proof would only further emphasize that the waters involved were "floods or flood waters" within the scope of Section 702c, as the Trial Court ultimately concluded. (See No. 7—Cl. Tr., p. 77; 204 F.2d 477, at 485; and No. 8 in the Conclusions of Law entered May 29, 1962—Cl. Tr., p. 37.) For example, appellants' principal contention in this regard is essentially that they were prevented from proving that a claimed 58,000 c.f.s. of water, which would have flowed out of the natural banks of the Feather River at Hamilton Bend upstream from the appellants' properties, was retained in the levee system until the breaks at Gum Tree and Nicolaus, whereupon those waters flooded the appellants' lands (Items l, m, n, p, p plus, q, r, s, t, u, and v—Op. Br., pages 19-22). Presumably, therefore, the appellants here contend that the waters so retained by the levees was the "proximate cause" of the levee breaks downstream from Hamilton Bend and near the appellants' lands. The appellants were thus merely offering to prove that water in excess of the capacity of the natural channel of the Feather River was confined by levees. But that is precisely what any levee system is intended to do—i.e., retain water in the system which would otherwise overflow the natural banks of the river and flood surrounding areas. The Trial Court ultimately found and concluded that

the waters so retained in the Feather River were "flood waters":

> "2. Prior to December 23, 1955, certain waters had overflowed the natural banks of the Feather, Yuba and Bear Rivers, and were being contained by a system of levees, which constituted part of the Sacramento River Flood Control Project.
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> * * *
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> "3. Water which has overflowed the natural banks of the stream in its natural channel, and which is contained by a system of levees, is 'flood water.' "[5]

If, as the appellants contend, such waters "proximately caused" the damage of which they complain, the situation is clearly within the scope of Section 702c, and the appellants' offers of proof defeat themselves.

Certain of the other offers apparently sought to prove that various levees were "negligently constructed" in one respect or another by the appellee (Items w, x, y, z, aa, and ab on page 22 of appellants' Opening Brief). Again, before such "negligent construction" could be relevant to the appellee's affirmative defense under Section 702c, the water necessarily would have had to been confined to the river by the levees. Such water would be water which, *except for the levees,* would have flowed beyond the natural banks of the river and would thus be flood waters. To have allowed the appellants to prove such matters would have neither changed the fact that the waters involved were "floods or flood waters" nor have affected the affirmative defense of the appellee. As the Trial Court observed, quoting from the testimony of

[5] Cl. Tr., pp. 76, 77; 204 F.Supp. 477, at 485, repeated as Finding No. 4 and Conclusion No. 4, respectively, in those entered May 29, 1962 (Cl. Tr., pp. 35, 36).

the appellee's expert witness, Professor Ray K. Linsley, Executive Head of the Department of Civil Engineering at Stanford University:

> "The rains resulted in run-off, an increase of streamflow from a low flow on the Feather River at the beginning of the month of under 5,000 cubic feet per second to a peak of slightly over 200,000 cubic feet per second, which hydrologists would certainly consider a flood event. The channels were filled with water above their natural banks; water was on the levees, and again * * * this we would consider a flood." (Cl. Tr., p. 68; 204 F. Supp. 477, at 481.)

Under the *Clark* and *National Mfg.* decisions, *supra,* it is clear that the Trial Court properly refused to receive any evidence on the issue of whether the flood here involved was "man-made."

IV. ARGUMENT

Under "A" of this portion of their Opening Brief, the appellants assert that their "basic contention" is that Title 33, U.S. Code, Section 702*c*, is a legislative recognition that the United States is not liable for damage proximately caused *solely* by an act of the elements, but does not prevent liability on the part of the United States where its negligence is either the *sole* proximate cause of damage, or proximately causes damage whether or not combined with an act of the elements or an "Act of God."

While it is not at all clear whether this "basic contention" is intended to supersede, supplement, or merely restate the contentions asserted in the preceding portions of the appellants' Opening Brief and discussed at pages

8 et seq., hereinabove, it is obvious that the appellants' *basic error* lies in their failure or refusal to accept the definitive decisions of this Court in the *Clark* case and of the Eighth Circuit in *National Mfg.* case (in which the Supreme Court later denied certiorari).

The appellants next discuss under "B" of their Opening Brief, what they term the "Congressional History of 33 USC 702"—apparently to dispute the conclusions of the Trial Court as to the meaning of the portion of Section 702*c* upon which the affirmative defense of the appellee is based (Op. Br., pp. 25-39).

Review of the excerpts from the legislative history cited by the appellants shows that they concern other portions of the bill involving other topics—particularly compensation for overflow or floodage rights rather than for flood damages—and are consequently irrelevant here. Significantly, none of such excerpts even mention the portion of Section 702*c* which is here involved, nor the discussion thereof in either the House of Representatives or the Senate.

The pertinent portion of Section 702*c* was introduced as a recommended amendment by the House Flood Committee while the bill (S. 3740) was under consideration by the House of Representatives sitting as a Committee of the Whole. The introduction, discussion, and adoption of that portion appear on pages 7022-7023 of Volume 69, Congressional Record (April 23, 1928), commencing with the following in the first column of page 7022:

> "The CHAIRMAN. [Mr. REID of Illinois] The Clerk will report the next amendment.
>
> "The Clerk read as follows:

"Page 4, line 22, after subparagraph (c) already adopted, add a new paragraph at the end of the section, as follows:

" 'No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place.' "

and concluding with the following from the second column on page 7023:

"The CHAIRMAN. . . . The question is on the amendment offered by the gentleman from Tennessee [Mr. GARRETT] to the amendment offered by the gentleman from Illinois, chairman of the committee.

"The question was taken; and on a division (demanded by Mr. GARRETT of Tennessee) there were 111 ayes and 70 noes.

"So the amendment of Mr. GARRETT of Tennessee to the amendment was agreed to.

"The CHAIRMAN. The question recurs on the amendment of the gentleman from Illinois as amended by the amendment of the gentleman from Tennessee.

"The question was taken, and the amendment as amended was agreed to."

The photocopies of these pages of the Congressional Record, which are included in the Appendix hereto, show that the particular language was adopted as proposed by the House Flood Control Committee—without change.

Following adoption by the House, the particular provision and the additional proposal by Representative Garrett were referred to as "House Amendment No. 14" in conference reports to the House and Senate—respec-

tively, H. Rept. No. 1505, H. Rept. No. 1555, and Sen. Doc. No. 96, 70th Cong., 1st Sess.—as follows:

> "No. 14 inserts the language proposed by the House but changes the latter part of the last paragraph of the section, so as to clarify the meaning."

Review of the debate and discussion of the bill in the Senate shows that House Amendment No. 14 was accepted without question—see 69 Cong. Rec. 8172; 8179-82; 8184-93 (May 9, 1928).[6]

It is apparent from the foregoing that once the language as to non-liability of any kind of the United States for floods or flood waters at any place was written into the bill, that language remained unchanged and subject to its natural meaning within its normal context—not to qualifications as the appellants urge.

As shown by the excerpts in the Appendix hereto, the legislative history of Section 702*c* was fully presented in the brief of the United States to this Court in the *Clark* case, *supra,* and those to the Eighth Circuit and to the Supreme Court in the *National Mfg.* case, *supra.*[7] The Eighth Circuit expressly relied on such legislative history in its decision in *National Mfg.*—from which it may be presumed that the action of the Supreme Court in denying certiorari therein was based, *pro tanto,* on that legislative history. Certainly, the peripheral argument of the appellants—based as it is on random excerpts from Congressional discussions of other por-

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[6] The references to "Senate discussions" on p. 33 of the appellants' Opening Brief are mistaken. Messrs. *Reid* and *Wilson* were not Senators, but members of the House of Representatives—speaking before that body—on other provisions of the bill—as cited pp. 8122 and 8211 of 69 Cong. Rec. clearly show.

[7] The excerpt quoted by the Eighth Circuit at pp. 272-273 of 210 F.2d in *National Mfg.* pertained to the consideration and rejection by Congress of bills to satisfy the claims of flood damage in the July 1951 flood of the Kansas River which were there involved.

tions of the statute—should not prevail against the legislative history of the particular portion of Section 702*c* involved herein, and upon which the decisions in *Clark* and *National Mfg.* were based and which the Court below followed in its decision.

As to the "Case History of Section 702c"—which the appellants discuss under "C" at pages 40-54 of their Opening Brief—it is to be noted that except for *Atkinson* v. *Merritt, Chapman & Scott Corp., et al., supra,* the decisions have all upheld the same defense under that section which the appellee has raised in the present litigation.

The *Atkinson* case—which the appellants discuss at pages 52-53 and 55 of their Opening Brief—involved damages resulting from the failure of a temporary cofferdam in the bed of the American River during the construction of Folsom Dam. As the Court below observed, that was an entirely different factual situation from damages resulting from floods and flood waters to areas beyond river banks and protective levees as in the present cases (Cl. Tr., p. 72; 204 F. Supp. 477, at 483). The decision in *Atkinson* was an interlocutory ruling on a contested motion for summary judgment. The motion was denied in order to permit the taking of evidence on the disputed facts. The case was eventually concluded as to the United States when the plaintiff voluntarily dismissed as against the United States. Thus, all that the decision in *Atkinson* actually represents is that whether a flood occurred is a matter of fact which the Court in that case could not properly determine on the contested motion for summary judgment. The distinction between natural and "man-made" floods which is suggested therein is not supported by the legislative

history or by any other court decision under Section 702c.

As to the "Flood cases which have recognized the liability of the United States for flood damage" which the appellants discuss at pages 55-65 of their Opening Brief, it should be noted that Section 702c was involved in only one such case—*Atkinson,* which we have discussed above. The other cases have no applicability to the present litigation, and require no further comment.

However, one of the others—*Aycrigg* v. *United States,* unreported, Civ. No. 6299, N.D. Calif. N.D. (1952), which the appellants discuss at pages 59-60 of their Opening Brief—may be mentioned in passing since it arose from a previous flood of the Feather River and was tried before the late Judge Dal M. Lemmon in the same District Court as the present cases. The *Aycrigg* case was not brought under a statute of general application but was specially authorized by Congress in Private Law No. 35, 81st Cong., 1st Sess., Ch. 86 (63 Stat. 1088). Private Law 35 waived the so-called "Tucker Act" jurisdiction of the U.S. Court of Claims and permitted the plaintiffs to sue in the District Court for flood damages allegedly resulting from negligence of the Corps of Engineers, U.S. Army. The very fact that a private law was necessary to create jurisdiction in the District Court and to waive the normal non-liability of the United States in such cases, in itself answers the appellants' contentions that such damages are ordinarily recoverable.[8]

[8] The appellants' assertion in the second paragraph on page 59 of their Opening Brief to the effect that more water flowed down the Feather River in the 1937 flood than in the 1955 flood is incorrect. As the Trial Court observed, it is necessary to go back nearly 50 years—to 1907—to find a larger flow in the Feather River than occurred in December 1955. (See text of decision and footnote 9 at p. 5, *supra.*).

In the appellants' discussion of "The Meaning of Section 702c" under "D" at pages 65-67 of their Opening Brief, it is contended that in order to establish a defense under Section 702c, the appellee must have proved that the damage to the appellants' property would have occurred if the flood control project had not been built. This is obviously a self-serving argument without foundation except in the appellants' own misinterpretation of the legislative history and court decisions under Section 702c. By this argument, the appellants would limit the application of Section 702c to situations in which the United States would not be liable —even without any such statutory provision. Such an argument is entirely contrary to the decisions of this Court in the *Clark* case and the Eighth Circuit in the *National Mfg.* case (in which the Supreme Court denied certiorari). The decision here on appeal was based on those decisions, is equally correct, and should not be modified or reversed because of the appellants' unfounded contentions to the contrary.

Likewise, the "Constitutionality of Section 702c"—which the appellants discuss under "E" at pages 69-74 of their Opening Brief—was considered and sustained in both the *Clark* and *National Mfg.* cases. The public policy asserted by Congress in Section 702c, which was based on prior statutes and practice over the years (as noted in the legislative history set forth in the Appendix hereto), and also in the numerous court decisions both before and after the enactment of Section 702c in 1928 (as discussed by this Court in *Clark* and the Eighth Circuit in *National Mfg.*), should not now be seriously questioned. The appellants' reliance on random expressions, principally from dissenting opinions, in the deci-

sions quoted on pages 72 and 73 of their Opening Brief —none of which involved Section 702c—certainly provides no basis for questioning the constitutionality of that section.

V. CONCLUSION

The appellants conclude their Opening Brief by asserting that Congress did not intend that the "innocent victims of such preposterous conduct" as that of the appellee in completing the Sacramento Flood Control Project at Hamilton Bend in the summer of 1955 "should bear the full financial burden of the Government's misconduct" (Op. Br., pp. 74-75). Further, that the Trial Court was erroneous in its interpretation of Section 702c of Title 33, U.S. Code. As we have shown herein, neither assertion is warranted on the facts or the law.

The appellants' Opening Brief neither comments upon nor attempts to refute any of the evidence presented by the appellee at trial as to the pertinent events here involved—i.e., the quantities of precipitation and streamflow, and the time and other circumstances of their occurrence. The only portion of their Opening Brief that even mentions those events appears under the heading "II—Statement of the Case," where it is conceded that the appellee proved there was a flood in the Feather River basin in December 1955 (Op. Br., pp. 2-6).

In brief, the testimony and exhibits presented by the appellee showed that the waters of the Feather, Yuba, and Bear Rivers as they emerged from the foothills on to the valley floor were of such magnitude and characteristics as to constitute "floods or flood waters" within any concept or definition. These waters did not cease

to be floods or flood waters merely because the United States undertook to confine them by flood control works. The waters were thus within the scope of the statutory terms which Congress used in Section 702c to bar recovery from the United States for any damage from or by such waters at any place.

We respectfully submit, therefore, that the Trial Court was correct in its interpretation and its application of Section 702c, and that its decision should be affirmed by this Court.

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WILLIAM B. SPOHN,
Assistant United States Attorney,
Attorneys for the Appellee.

CERTIFICATE OF COUNSEL

I certify that, in preparing this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the brief is in full compliance with those rules.

May 15, 1963.

WILLIAM B. SPOHN,
Attorney for the Appellee.

Appendix

Topical Index of Evidence

A. Re GEOGRAPHIC AREA and general description of flood in December 1955:

Testimony and exhibits by witness Jack L. Newman, Supervising Civil Engineer, U. S. Army, Corps of Engineers, Sacramento: Reporter's Transcript of Trial Proceedings (Vol. II of Clerk's Transcript), pp. 318-355; Exhs. A thru I.

B. Re PERTINENT WEATHER EVENTS:

Testimony and exhibits by witness Lloyd H. Magar, Meteorologist-in-Charge, U. S. Weather Bureau, Sacramento: Rep. Tr., pp. 355-550; Exhs. O, Q, U, V, W, and X.

C. Re PERTINENT STREAMFLOW EVENTS:

Testimony and exhibits by witness Walter Hofmann, District Engineer, Surface Water Branch, U. S. Geological Survey, Menlo Park: Rep. Tr., pp. 551-593; Exhs. R, S, and Y.

D. Re SIGNIFICANCE OF WEATHER AND STREAMFLOW EVENTS:

Testimony of Ray K. Linsley, Professor and Executive Head of the Department of Civil Engineering, Stanford University, Palo Alto: Rep. Tr., pp. 593-660.

Appendix

Legislative History, etc., of Title 33, U. S. Code, Section 702c.

(Excerpt from pages 108 through 118 of USA brief to 9th Circuit in *Clark* v. *United States*, 218 F.2d 446 (1954)).

G. Congress Has Provided That the United States Shall Not Be Liable for Flood Damage.

Claims against the United States on account of flood damage are not novel. Floods are one of the most persistent of the nation's problems. The loss is frequently tremendous. The 1948 Columbia River flood caused damage estimated at one hundred million dollars. The property loss in the recent Kansas City flood was approximately two and one-half billion dollars. "The average annual losses from flood damage in the United States have been estimated from 100 to 500 million dollars * * *" (H. Rep. No. 1088, 82d Cong. 1st Sess., p. 6). Congress has always been unwilling to become responsible for flood damage. In response to a suggestion that the Government undertake an indemnity program for the victims of the Kansas City flood, the House Committee said:

> "The budget request includes a proposal to indemnify flood victims for physical loss of or damage to tangible real or personal property up to 80 percent of the amount of such loss, provided that the amount to be paid any one person submitting such a claim does not exceed $20,000. [p. 108]* The Committee heard considerable testimony on this recommendation, and after careful deliberation has not approved it for several important reasons.
>
> "Congress has never appropriated funds for

*Figures in brackets indicate end of page in original brief.

indemnities such as have been proposed here in any previous disaster of this kind, and no legislation has ever been enacted by Congress authorizing such appropriations. This would be a major departure from the present concept of Government and, therefore, must be given more extensive study than is now possible under emergency conditions that demand prompt action on the part of the Congress. The Committee believes that the approval of the proposed indemnification program would commit the Federal Government to a new concept of Federal responsibility which would result in an almost unlimited number of claims from victims of every 'Act of God' disaster throughout the country regardless of the type or size of the disaster. The financial implications inherent in such an action would be enormous." (H. Rep. No. 1092, 82d Cong. 1st Sess., p. 5.)

The courts have been as unwilling as Congress to "commit the Federal Government to a new concept of Federal responsibility which would result in an almost unlimited number of claims from victims of every 'Act of God' disaster." For many years and in a wide variety of circumstances, claims have been filed under the Fifth Amendment seeking compensation for damage caused by the Government's [p. 109] flood control operations. They have always been denied. *Bedford v. United States,* 192 U.S. 217, 224 (1904); *Jackson v. United States,* 230 U.S. 1, 23 (1913); *Cubbins v. Mississippi River Commission,* 241 U.S. 351 (1916); *Sanguinetti v. United States,* 264 U.S. 146 (1924); *United States v. Sponenbarger,* 308 U.S. 256 (1939); *Oklahoma v. Atkinson Co.,* 313

U.S. 508 (1941); *Gulf Refining Co. v. Mark C. Walker & Son Co.,* 124 F.2d 420 (C.C.A. 6, 1943); *United States v. West Virginia Power Co.,* 122 F.2d 733 (C.C.A. 4, 1941); *Goodman v. United States,* 113 F.2d 914 (C.C.A. 8, 1940); *Lynn v. United States,* 110 F.2d 586 (C.C.A. 5, 1940); *Franklin v. United States,* 101 F.2d 459 (C.C.A. 6, 1939). This is true even though the Federal officers, as an emergency measure, have dynamited levees, thereby inundating plaintiffs' property. *Hughes v. United States,* 230 U.S. 24 (1913); *Danforth v. United States,* 308 U.S. 271, 287 (1939).

This result does not depend upon doctrines of sovereign immunity or limitations in the Fifth Amendment. The Tennessee Valley Authority is subject to suit. Nevertheless, flood damage claims against it, even though asserted in terms of negligence or wrongful conduct, cannot be maintained. See *Grant v. T.V.A.,* 49 F. Supp. 564, 566 (1942). *Atchley v. T.V.A.,* 69 F. Supp. 953, 954 (1947). The decisive considerations are those of public policy. As Mr. Justice McKenna said in *Bedford v. United States,* 192 U.S. 217, 223 (1904): [p. 110]

> "The consequences of the contention immediately challenge its soundness. What is its limit? * * * And if the government is responsible to one landowner below the works, why not to all landowners? The principle contended for seems necessarily wrong. * * * Conceding the power of the government over navigable rivers, it would make that power impossible of exercise, or would prevent its exercise by the dread of an immeasurable responsibility."

To the extent that flood damage claims are founded upon the Fifth Amendment, they are, of course, beyond Congressional control. In the area, however, in which Congress is free to act, including the area of these cases, Congress has unequivocally forbidden recognition of such claims. The Court below concluded:

> "19. The provision of 33 U.S.C.A. 702(c) that 'No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place' is an absolute defense to these actions. The statute is valid; it is applicable to the Columbia River; and it was not repealed by the Federal Tort Claims Act."

In denying recognition to any claim against the United States on account of flood damage, Congress was unequivocal and emphatic. And Congress meant exactly what it said.

Federal flood control legislation in this country goes back to 1851. In the general appropriation act [p. 111] for that year Congress provided $50,000 "For the topographical and hydrographical survey of the Delta of the Mississippi * * *" (9 Stat. 523, 539). In 1879 the Mississippi River Commission was created and obligated to prepare for Congress "such plan or plans and estimates as will correct, permanently locate, and deepen the channel and protect the banks of the Mississippi River; improve and give safety and ease to the navigation thereof; prevent destructive floods; promote and facilitate commerce, trade, and the postal service; * * *" (21 Stat. 37, 38). In

1893 Congress created the California Debris Commission and instructed it to look into problems of navigability and flood control on California rivers (27 Stat. 507). In 1917 by an Act "To provide for the control of the floods of the Mississippi River and of the Sacramento River, California," Congress appropriated forty-five million dollars to be expended for flood control purposes (at the rate of ten million dollars a year) under the direction of the Secretary of War and in accordance with plans of the Mississippi River Commission and the California Debris Commission (39 Stat. 948). And thus the matter stood until 1927.

In 1927 the Mississippi Valley was devastated by its flood of record. Congress immediately gave consideration to flood control measures, culminating in the Flood Control Act of 1928 (45 Stat. 534) entitled "An Act for the Control of floods on the Mississippi River and its tributaries, and for other purposes." [p. 112] Section 1 establishes a board of engineers to study Mississippi problems. Section 2 approves the principle of local contribution to the cost of flood control with specific exceptions. Section 3, paragraph one, obligates local interests to provide easements and rights of way and to assume responsibility for the maintenance and operation of the levee structures to be built under the Act. The second paragraph of Section 3 contains the language which now appears as Section 702c of Title 33. That paragraph reads as follows:

> "No liability of any kind shall attach to or rest upon the United States for any damage

from or by floods or flood waters at any place; *Provided, however,* That if in carrying out the purposes of this Act it shall be found that upon any stretch of the banks of the Mississippi River it is impracticable to construct levees, either because such construction is not economically justified or because such construction would unreasonably restrict the flood channel, and lands in such stretch of the river are subjected to overflow and damage which are not now overflowed or damaged by reason of the construction of levees on the opposite banks of the river it shall be the duty of the Secretary of War and the Chief of Engineers to institute proceedings on behalf of the United States Government to acquire either the absolute ownership of the lands so subjected to overflow and damage or floodage rights over such lands."

The statute goes on to provide for acquisition of flowage rights by the United States, for participation [p. 113] of various Government agencies in work to be done under the Act, for distribution of funds in connection with the Mississippi program, for further reports and studies and, finally, for a limitation on the contribution of the United States to flood control measures proposed by the California Debris Commission for California rivers.

The no-liability language of Section 3 came into the Act as a result of a conference between the House and Senate managers and without explanation (see H. Rep. No. 1505, 70th Cong., 1st Sess.). But it is not difficult to identify the source of this provision. President Coolidge in his 1927 State-of-the-Union message (Cong. Rec. Sen., Dec. 7, 1927, p. 106) re-

viewed the problems created by the 1927 flood, proposed additional flood control legislation, and added words of caution about the position of the Government. He said:

> "It is necessary to look upon this emergency as a national disaster. It has been so treated from its inception. Our whole people have provided with great generosity for its relief. Most of the departments of the Federal Government have been engaged in the same effort. The governments of the afflicted areas, both State and municipal, can not be given too high praise for the courageous and helpful way in which they have come to the rescue of the people. If the sources directly chargeable can not meet the demand, the National Government should not fail to provide generous relief. This, however, does not mean restoration. The Government is not [p. 114] an insurer of its citizens against the hazard of the elements. We shall always have flood and drought, heat and cold, earthquake and wind, lightning and tidal wave, which are all too constant in their afflictions. The Government does not undertake to reimburse its citizens for loss and damage incurred under such circumstances. It is chargeable, however, with the rebuilding of public works and the humanitarian duty of relieving its citizens from distress."

This is clear enough: the Federal Government will extend its flood control program and provide relief where relief is needed; but it will not pay for flood damage. Section 3 was intended to put this point beyond argument. And it does so. There is no conflicting view. See *United States v. Sponenbarger,*

308 U.S. 256, 269 (1939); *Kincaid v. United States,* 35 F.2d 235, 246 (D.C. W.D. La., 1929).

Appellants argued in the Court below that Section 702c has no application in the Columbia River Basin. That argument has no force. 1. The 1928 Act, relating as it did to flood control on the Mississippi and Sacramento Rivers, related to all flood control work which the Government had undertaken in the past or was proposing for the future. Hence, in providing against liability in this statute, Congress was, in effect, providing against all liability. 2. The provision itself, referring as it does to "damage from or by floods or flood waters *at any place*", specifically negatives appellants' idea of a limited geographical application. 3. President Coolidge in his message to [p. 115] Congress was obviously suggesting policy for all flood activities of the Government, wherever located. 4. The Flood Control Act of 1936, which included provision for work in the Columbia River Basin, specifically affirmed all the provisions of the 1928 statute, thus making it plain that Section 702c has full application in the Columbia River Basin. Prior to 1936 the 1928 Act was amended from time to time in minor particulars (46 Stat. 787, 47 Stat. 810, 48 Stat. 607, 49 Stat. 1508); but there was no new general flood control legislation until that year. In 1936 Congress greatly extended the flood control activities of the Government approving many projects, including approximately fifty in the Columbia Basin (49 Stat. 1570, 1589). Congress was careful, however, to reaffirm the principles and provisions of the 1928 Act. Section 8 of the 1936 statute (49 Stat. 1570, 1596) provides:

> "Nothing in this Act shall be construed as repealing or amending any provision of the Act entitled 'An Act for the control of floods on the Mississippi River and its tributaries, and for other purposes', approved May 15, 1928, or any provision of any law amendatory thereof. * * *"

Thus it is beyond dispute that Congress intended that all provisions of the 1928 Act, including the no-liability provision, should apply in the Columbia Basin. Since 1936 there has been a variety of flood control statutes of one kind or another but nothing to modify this conclusion. (See 52 Stat. 1215, 53 Stat. 1414, 55 Stat. 638, 58 Stat. 887, 60 Stat. 641, 62 Stat. 1040). [p. 116]

Appellants argue that Section 702c has been modified by the Tort Act. This argument, as the Court below concluded, has no merit. 1. The Tort Act did no more than to waive the defense of sovereign immunity. It did not repeal existing acts of Congress or create claims against the United States which did not theretofore exist. *Feres v. United States,* 340 U.S. 135 (1950). 2. By its terms the Tort Act did not repeal or modify Section 702c and the most that could be said, therefore, is that there has been a repeal by implication. "But it is elementary that repeals by implication are not favored. Only a clear repugnancy between the old law and the new results in the former giving way and then only pro tanto to the extent of the repugnancy." *Georgia v. Pennsylvania R. Co.,* 324 U.S. 439, 456 (1945); *United States v. Borden,* 308 U.S. 188, 198 (1939). It is uniformly held, moreover, that a later statute written in general terms, such as the Tort Act, will not (absent an

express provision) be construed to supersede an earlier specific statute, such as Section 702c relating to liability for flood damage. "It is a canon of statutory construction that a later statute, general in its terms and not expressly repealing a prior special statute, will ordinarily not affect the special provisions of such earlier statute." *Rodgers v. United States,* 185 U.S. 83, 87 (1902); *Stewart v. United States,* 106 F. 2d 405, 408 (C.C.A. 9, 1939); *United States v. Hughes,* 116 F. 2d 171, 174 (C.C.A. 3, 1940); *The Town of Okemah v. United States,* 140 F. 2d 963, 965 [p. 117] (C.C.A. 10, 1944); *Home Owners Loan Corporation* v. *Creed,* 108 F. 2d 153, 155 (C.C.A. 5, 1939).

The provisions of 33 U.S.C.A. 702c are an absolute bar to these claims. [p. 118]

Legislative History, etc., of Title 33, U. S. Code, Section 702c.

(Excerpt from pages 15 through 21 of USA brief to 8th Circuit in *National Mfg. Co. v. United States*, 210 F.2d 263 (1954)).

B. THE TERMS OF SECTION 3 OF THE ACT OF MAY 15, 1928, 33 U. S. C. 702 (c), CONFIRM THE INTENT OF CONGRESS NOT TO SUBJECT THE UNITED STATES TO LIABILITY FOR FLOOD DAMAGE.

Still further support for the view that Congress did not intend to subject the United States to liability for flood damages is [p. 15] found in the unambiguous language of Section 3 of the Act of May 15, 1928, 45 Stat. 534, 536, 33 U. S. C. 702 (c). In precise language Section 3 declares that:

> No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place.

No broader or more emphatic language could, we submit, have been employed to exonerate the United States from flood-damage liability. The statutory language is unequivocal. The United States cannot be subjected to *any* kind of liability for *any* flood damage at *any* place. Congress undoubtedly knew that unless the exculpatory language was cast in comprehensive terms, attempts would be made, as they are being made here, to restrict its scope. And Congress carefully drafted the statute in all-inclusive language to forestall such attempts. It is for that reason that Congress expressly outlawed liability "of *any* kind." It is for that reason that Congress made it clear that the statutory immunity extended not only to claims for damages resulting directly or indirectly from floods but also to

those caused directly or indirectly by flood waters. And it is for that reason that the Congress, instead of placing any geographical limitation on the statute's applicability, used the language "at *any* place," to make certain that the statute would be applied generally and uniformly throughout the country wherever flood damage might be sustained.

That this literal language of Section 3 prohibits recovery of the damages here sought can scarcely be challenged. Indeed, the complaints in the consolidated cases concede, as they must, that the damages involved resulted from the fact that the "wares and mechandise (owned by the appellants) were flooded and inundated by the flood waters and oil, mud, muck and debris carried therewith" (R. N. 7, 8). Likewise, the *Shipley Company* complaint acknowledges that the damages sought resulted when the Kansas River "flooded the Central Industrial District and destroyed and damaged" that Company's personal property (R. S. 4, 5). These concessions, showing that the damages resulted from the flood or flood waters, establish the applicability here of Section 3's prohibition [p. 16] against federal liability. And they also establish the correctness of the decisions below in relying on Section 3 as a ground for dismissal of the complaints.

Three contentions are nevertheless advanced by appellants in endeavoring to avoid the impact of Section 3's bar against liability. First, it is argued that the prohibition applies only to floods occurring on the Mississippi River. Their second contention is that Section 3 of the 1928 Act immunizes the Government from liability only where the damage is proximately caused by the flood and that here the proximate causes were the negli-

gent predictions and assurances of safety by the Weather Bureau and Corps of Engineers. Finally, appellants contend that the 1928 Act was impliedly repealed by enactment of the Federal Tort Claims Act on August 2, 1946. There is no substance, we submit, to any of these contentions.

a. Appellants' first contention completely ignores Section 3's mandate that flood damage occurring *"at any place"* may *not* be compensated by the United States. As we have shown, Congress could not possibly have employed broader language to effectuate its purpose in making the statute applicable throughout the United States. Nor do appellants suggest any language more appropriate to achieve that end.

Nevertheless, they argue that this Court should strike out the all-inclusive statutory reference to damages occurring at "any place" and substitute instead a reference to damages occurring "along the Mississippi River." And, as justification for this argument, they point to the caption "Mississippi River" for Section 702 of Title 33, U. S. C., under which is codified Section 3 of the 1928 Act. But this caption was apparently derived from the Act of March 1, 1917, 39 Stat. 948, and *not* from the Act which contains the "no liability at any place" provision. The 1928 Act, unlike the 1917 Act, is not limited to the Mississippi but also applies to the tributaries of the Mississippi and to the tributaries of those tributaries. Thus, Section 10 of the 1928 Act expressly refers to the Mississippi *and* "the Missouri River and tributaries." 45 Stat. 534, 538.[9]

[9]The legislative history of the 1928 Act shows strong congressional concern with the need for having the Act apply not only to the Mississippi but to its tributaries and the rivers flowing into those tributaries. As origi- [p. 17]

Since the Kansas River is a tributary of the Missouri, which in turn is the chief tributary of the Mississippi, the "at any place" provision cannot, as contended by appellants, be restricted to the Mississippi but must be interpreted to also apply at least to those rivers, including the Kansas, which flow either directly or indirectly into the Mississippi.

There is more than the language contained in the 1928 Act which makes it plain that when Congress said "any place" it necessarily included floods on the Kansas River. In the Flood Control Act of 1936, which contained specific provisions concerning floods on the "Missouri River basin" and an express and detailed reference to "Kansas Citys on Missouri and Kansas Rivers in Missouri and Kansas" (49 Stat. 1570, 1588), Congress specifically affirmed all the provisions of the 1928 statute. Section 8 of the 1936 Act (49 Stat. 1570, 1596) provides:

> Nothing in this Act shall be construed as repealing or amending any provision of the Act entitled "An Act for the control of floods on the Mississippi River and its tributaries, and for other purposes,"

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nally introduced, the bill which became the 1928 Act was entitled "For the Control of Floods on the Mississippi River from the Head of the Passes to Cape Girardeau, Missouri, and Other Purposes (69 Cong. Rec. 5490)." This title was quickly objected to in Congress as being too limited, since the bill was intended to apply "not only to the Lower Mississippi but likewise on all the rivers which flow into the Mississippi" (69 Cong. Rec. 5489). Discussion in the Senate further showed that Congress intended the bill to apply not only to the Mississippi but also to "The Tributaries of the Mississippi and on Their Main Tributaries" (69 Cong. Rec. 5490). It was pointed out that "no plan for flood control in the Mississippi Valley can be adequate or acceptable" without "a complete system of Federal control of floods on the tributaries" (62 Cong. Rec. 5489-5490). Only by controlling floods on the tributaries can there be effective control on the main streams. For that reason, the limited reference to the portion of the Mississippi between the Head of the Passes and Cape Girardeau was stricken and the title broadened to read "For the Control of Floods on the Mississippi River and Its Tributaries, and for Other Purposes" (69 Cong. Rec. 5490) (45 Stat. 534).

> approved May 15, 1928, or any provision of any law amendatory thereof. * * *

This specific affirmation completely wipes out any basis for challenging Section 3's applicability to the Kansas River flood claims asserted in the instant cases.

This 1936 statute also shows that appellants' reliance on the limited "Mississippi River" language in Section 702 of the United States Code is misplaced. A Code provision is, of course, only *prima facie* evidence of the law (1 U. S. C. 204 (a)). When, as here, it is inconsistent with the 1936 statute as it appears in the Statutes at Large, the latter must prevail. *Stephan v. United States,* 319 U.S. 423, 426; *Wong Yang Sung v. McGrath,* 339 U.S. 33, 51, note 33; see also *Balian Ice Cream Co. v. Arden Farms Co.,* 94 F. Supp. 796, 802 (S.D. Cal.). Accordingly, the fact that the words, "Mississippi River[10] have "lingered on in the successive editions of the United States Code is immaterial." Cf. *Stephan v. United States,* 319 U.S. 423, 426.

b. Equally lacking in merit is the contention that Section 3 applies only where the damages are proximately caused by floods or flood waters. That is not what the statute provides. To the contrary, its plain language bars federal liability for "damages from or by floods or flood waters." Statutory use of the word "from" in addition to the word "by" dissipates any doubt that the bar against liability applies to damages resulting from any situation in which floods or flood waters constitute a material or substantial factor. Use of the additional word "from" is the short and conclusive answer to the argument that the statute applies only where damage is proximately caused *by* floods or flood

waters.[10] It is significant here to note that where Congress, as in the Federal Tort Claims Act, did want to incorporate the rules of proximate causation it deliberately omitted the word "from" and referred to "damages * * * caused by" the employee's tortious conduct. 28 U. S. C. 1346(b).

Judge Fee's decision in *Clark v. United States,* 109 F. Supp. 213, 227 (D.C. Oreg.), holding Columbia River flood damage claims barred by Section 3 of the 1928 Act, weakens appellants' contention still further. That decision cannot be brushed aside, as appellants have attempted, on the ground that it "has [p. 19] no applicability to the facts in this case where the proximate cause of the damage was not the flood, but negligence in regard to the assurances issued." Appellants' Brief, *National Manufacturing* case, p. 37. Judge Fee's opinion and his printed pre-trial order in the *Clark* case shows very plainly that, as in the instant cases, it was there claimed that the damages were proximately caused not by the flood but by negligent assurances of safety by "withholding vital information with respect to danger to Vanport by flood," and by "failing and refusing to warn plaintiffs" of the impending flood. See *Clark v. United States,* 13 F. R. D. 342, 380, 109 F. Supp. 213, 225, 226 (D.C. Oreg.).

c. Nor is there any substance to the claim that Section 3 of the 1928 Act is not dispositive here because it was impliedly repealed by the Federal Tort Claims Act of August 2, 1946. "It is a cardinal principle of construction that repeals by implication are not favored." *United*

[10]Nor do we accept appellants' premise that the Kansas River flood was not the proximate cause of their damages. The allegations in their complaints, standing alone, show that the flood was in fact the proximate cause of the damages claimed in this litigation. (See *supra,* p. 16.) [p. 19]

States v. Borden Co., 308 U.S. 188, 198. In addition, the suggestion that there was an implied repeal is refuted by specific provisions of the Tort Claims Act which *expressly* repealed those earlier statutes Congress did intend the Tort Claims Act to supplant. Thus, Section 424(a) of the Tort Claims Act declares that a series of specifically described statutes "are hereby repealed" (60 Stat. 842, 846). The list of statutes expressly repealed does not include the 1928 Act (60 Stat. 842, 846, 847). If Congress had intended to repeal Section 3 of the 1928 Act, it would have been a simple matter to add that statute to the list of those expressly repealed. The omission of Section 3 from that list is persuasive evidence that it is in full force and in no way affected by enactment of the Tort Claims Act. See *Clark v. United States,* 109 F. Supp. 213, 227-228 (D.C. Oreg.).

C. Consistent Judicial Decisions Reflect This Traditional Congressional Policy Against Federal Liability for Flood Damage.

Flood damage suits against the United States are not novel. But, as is apparent from appellants' failure to refer to even one case in which recovery has been allowed, such claims have been uniformly rejected by the courts. *Bedford v. United States,* 192 U.S. 217; *Jackson v. United States,* 230 U.S. 1; *Sangui-* [p. 20] *netti v. United States,* 264 U.S. 146; *United States v. Sponenbarger,* 308 U.S. 256; *Goodman v. United States,* 113 F.2d 914 (C.A. 8).

This consistent result, reflecting traditional congressional reluctance to subject the United States to the enormous liability of flood damage claims, cannot be explained away on the basis of limitations in the Fifth

Amendment, nor on the ground that it is a consequence of the doctrine of sovereign immunity. Thus, flood damage claims, even though based on negligence, asserted against the Tennessee Valley Authority, which is subject to suit, are not maintainable. *Grant v. Tennessee Valley Authority,* 49 F. Supp. 564 (D.C. Tenn.). In granting defendant's motion for summary judgment, the court noted (49 F. Supp. 564, 566):

> By a long line of cases it has definitely been settled that neither the government nor its instrumentalities would have to respond in damages arising in the development and maintenance of waters for purposes of navigation and flood control, *including claims for negligence. It may be noted that this position is not because of governmental immunity from suit but on the grounds of public policy.* (Emphasis supplied.)

Similarly, in *Atchley v. Tennessee Valley Authority,* 69 F. Supp. 952, 954 (N.D. Ala.), a motion for summary judgment was again granted, the court pointing out that the principle of nonliability for flood damage "is not based upon the immunity to suit of the United States" and "applies whether the alleged liability is predicated on nuisance, negligence or other tortious conduct."

II

THERE IS NOTHING IN THE TORT CLAIMS ACT WHICH INDICATES THAT CONGRESS INTENDED TO DEPART FROM THE TRADITIONAL POLICY AGAINST FEDERAL LIABILITY FOR FLOOD DAMAGES

In the light of (1) the firmly established congres-

sional policy against indemnification of flood claims, (2) the direct prohibition against flood liability incorporated in Section 3 of [p. 21] the 1928 statute, 33 U. S. C. 702 (c), and (3) the consistent judicial decisions refusing to assess flood damage liability against the United States, we submit that it would require express and unequivocal language in the Federal Tort Claims Act to justify imposition of such liability under that Act. "If Congress had intended such a drastic change in the long established public policy [against federal responsibility for flood liability], it would have been more specific." *Grant v. Tennessee Valley Authority,* 49 F. Supp. 564, 566 (D.C. Tenn.). And, as similarly stated by the Supreme Court in rejecting for the same reason other negligence claims under the Federal Tort Claims Act, "We cannot impute to Congress such a radical departure from established law in the absence of express congressional command." *Feres v. United States,* 340 U.S. 135, 146.

We submit that the instant claims must be denied because there is no express congressional command in the Tort Claims Act on which appellants can rely in seeking to impose flood damage liability on the United States. We further submit that the express exceptions in the Tort Claims Act [Title 28, U. S. Code, Section 2680] apply to these claims, making it doubly clear that they are not cognizable under the Act. [p. 22]

Legislative History, etc., of Title 33, U. S. Code, Section 702c.

(Excerpt from pages 10 through 13 of USA brief to Supreme Court in opposition to petition for certiorari in *National Mfg. Co. v. United States*, 347 U.S. 967 (1954)).

ARGUMENT

The decision of the Court of Appeals in these Tort Claims Act cases is plainly correct. As noted in the opinions below, there are several independent and dispositive reasons for denying the claims. Some of these grounds are narrowly limited to flood cases of this precise type, and the broader grounds are in full accord with the rulings of this Court and of the other circuits.

1. The holding is firmly supported by the unambiguous language of Section 3 of the Act of May 15, 1928, 45 Stat. 534, 536, 33 U.S.C. 702c. In precise language, Section 3 declares that: [p. 10]

> No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place * * *.

(a). No broader or more emphatic language could have been employed to exonerate the United States from flood-damage liability. The statutory language is unequivocal. The United States cannot be subjected to *any* kind of liability for *any* flood damage at *any* place. Congress undoubtedly knew that, unless the exculpatory language was cast in comprehensive terms, attempts would be made to restrict its scope. And, as observed by the court below, "Congressional anticipation" of such

attempts resulted in the statute's use of broad, all-inclusive language. (R.N. 34; R.S. 25.) It is undoubtedly for that reason that Congress, in Section 3, expressly outlawed liability "of *any* kind." Congress made it clear that the statutory immunity extended not only to claims for damages proximately caused by floods or flood waters but also, as the court below noted, to claims where the floods or flood waters were only a "substantial" or "material" factor in destroying or damaging property (R.N. 34; R.S. 25). And Congress, instead of placing any geographical limitation on the statute's applicability, used the language "at any place," to make certain that the statute would be applied "uniformly and throughout the country" wherever flood damage might be sustained (R.N. 34; R.S. 25).

That the language of Section 3 prohibits re- [p. 11] covery of the damages claimed by petitioners is apparent from the complaints. Five of the complaints concede, as they must, that the damages involved resulted from the fact that the "wares and merchandise [owned by the petitioners] were flooded and inundated by the flood waters and oil, mud, muck and debris carried therewith" (R.N. 7, 8). Likewise, the *Shipley Company* complaint acknowledges that the damages sought resulted when the Kansas River "flooded the * * * Central Industrial District and destroyed and damaged" that Company's personal property (R.S. 4, 5). These concessions, as the court below held, show that "the language of Section 3 plainly bars recovery against the United States." (R.N. 34, 38; R.S. 25, 29.)

(b). Congress has never departed from this "basic concept of nonliability" (R.N. 35, R.S. 26) adopted in

the Flood Control Acts.[5] On the contrary, the legislative history of bills considered by Congress "immediately following the [July 1951] flood shows even more conclusively congressional opposition to indemnification [for the flood damage] sought in the instant suits." (See the excerpts from the government's brief incorporated in the opinion below as fn. 3, R.N. 35, R.S. 26). The [p. 12] stark fact is, as shown by these excerpts, that these very claims were emphatically rejected by the Congress.[6]

[5]It is also significant that, as the opinion below points out, while "Many attempts have also been made in the courts to impose liability upon the United States for flood damages * * * such claims have been uniformly rejected by the courts. *Bedford v. United States,* 192 U.S. 217; *Jackson v. United States,* 230 U.S. 1; *Sanguinetti v. United States,* 264 U.S. 146; *United States v. Sponenbarger,* 308 U.S. 256; *Goodman v. United States,* 8 Cir., 113 F. 2d 914." (R.N. 36-37; R.S. 27-28). See also *Grant v. Tennessee Valley Authority,* 49 F. Supp. 564, 566 (E.D. Tenn.); *Atchley v. Tennessee Valley Authority,* 69 F. Supp. 952, 954 (N.D. Ala.). [p. 12]

[6]Although more than a thousand cases are filed each year against the United States under the Federal Tort Claims Act, the instant suits seem to be the first and only attempts to obtain judgments against the United States on claims as to which Congress has earlier declared its express opposition. The usual pattern is the converse, *i.e.,* attempts to obtain legislative relief after judicial rejection of a claim. [p. 13]

stances to protect the Government. There have been times, I admit, when some have succeeded in defrauding the Government; and the cases of Fall and Sinclair as well as Doheny have shown that it is necessary to provide safeguards for the protection of the Government.

The CHAIRMAN. The question is on agreeing to the amendment offered by the gentleman from New York [Mr. LAGUARDIA].

The question was taken; and on a division (demanded by Mr. LAGUARDIA) there were—ayes 37, noes 110.

So the amendment was rejected.

The CHAIRMAN. The question recurs on the amendment offered by the gentleman from Wisconsin.

Mr. FREAR. That takes out the latter part of the section. Mr. Chairman, may we have the amendment again reported?

Mr. REID of Illinois. Mr. Chairman, I demand the regular order.

The CHAIRMAN. The regular order is on agreeing to the amendment offered by the gentleman from Wisconsin.

The question was taken, and the amendment was rejected.

The Clerk read as follows:

SEC. 3. Except when authorized by the Secretary of War upon the recommendation of the Chief of Engineers, no money appropriated under authority of this act shall be expended on the construction of any item of the project until local interests have given assurances satisfactory to the Secretary of War that they will (a) maintain all flood-control works after their completion, except controlling and regulating spillway structures, including special relief levees; maintenance includes normally such matters as cutting grass, removal of weeds, local drainage, and minor repairs of main-river levees; (b) agree to accept land turned over to them under the provisions of section 4.

With the following committee amendment:

In line 21, after the word "accept," insert the words "the title to."

The CHAIRMAN. The question is on agreeing to the committee amendment.

The committee amendment was agreed to.

Mr. MADDEN. Mr. Chairman, I offer an amendment.

Mr. REID of Illinois. Mr. Chairman, I have sent three amendments to the desk.

The CHAIRMAN. There are three amendments which will be disposed of, amendments which have been heretofore submitted and which the Clerk will report.

The Clerk read as follows:

Page 4, line 15, strike out the words "local interests" and insert in lieu thereof the words "the States or levee districts."

The CHAIRMAN. The question is on agreeing to the amendment.

The amendment was agreed to.

The CHAIRMAN. The Clerk will report the next amendment.

The Clerk read as follows:

Page 4, line 22, after the figure "4," change the period to a semicolon and insert the following as subparagraph (c):

"(c) Provide without cost to the United States all rights of way for levee foundations and levees on the main stem of the Mississippi River between Girardeau, Miss., and the Head of Passes."

The CHAIRMAN. The question is on agreeing to the amendment.

The amendment was agreed to.

The CHAIRMAN. The Clerk will report the next amendment.

The Clerk read as follows:

Page 4, line 22, after subparagraph (c), already adopted, add a new paragraph at the end of the section, as follows:

"No liability of any kind shall attach to or rest upon the United States for any damage from or by floods or flood waters at any place."

The CHAIRMAN. The question is on agreeing to the amendment.

Mr. MADDEN. Mr. Chairman, I do not think this ought to be in this section of the bill. I do not think it should be attached to this section of the bill.

Mr. FREAR. This has been agreed on.

Mr. MADDEN. We agreed to it, but I do not think it should be made a part of this section.

Mr. GARRETT of Tennessee. Mr. Chairman, I offer an amendment to the amendment.

The CHAIRMAN. The gentleman from Tennessee offers an amendment to the amendment offered by the gentleman from Illinois, which the Clerk will report.

The Clerk read as follows:

Amendment offered by Mr. GARRETT of Tennessee to the amendment offered by the gentleman from Illinois [Mr. REID]: At the end of the amendment insert: "*Provided, however,* That if in carrying out the purposes of this act it shall be found that upon any stretch of the banks of the Mississippi River it is impracticable to construct works for the protection of adjacent lands, and that such adjacent lands will be subject to damage by the execution of the general flood-control plan, it shall be the duty of the board herein provided to cause to be acquired on behalf of the United States Government either the absolute ownership of the lands so subjected to overflow or floodage rights over such lands."

Mr. GARRETT of Tennessee. Mr. Chairman, I am inclined to agree with the gentleman from Illinois [Mr. MADDEN] that the amendment which the gentleman from Illinois [Mr. REID] has proposed more properly would come in another section, but if it is to come now it seems to me that my amendment will have to come in connection with it at this place. I do not want to lose any rights in connection with it.

Mr. MADDEN. If the gentleman will yield, I am in favor of the amendment offered by my colleague, but I propose to strike out section 3 and offer a substitute to section 3, and I do not want to strike out that part of it.

Mr. REID of Illinois. That is the reason we had better get it in.

Mr. MADDEN. No. I will move to strike it out, anyway, if the gentleman wants to do it that way. I do not think it is fair; that is all. I think an amendment should be considered on its merits without any attempt to foreclose the right to have proper consideration of it. It does not matter how much power anybody has, it is just as well to exercise it with justice; and it does not make any difference how many votes you may have on a given proposition, it is well to exercise proper respect for the facts in the case.

Mr. REID of Illinois. Will the gentleman from Illinois yield?

Mr. MADDEN. Yes.

Mr. REID of Illinois. This was submitted at this place by the gentleman's conferees and we put it in at the gentleman's request.

Mr. MADDEN. The gentleman put it in, but it was not put in here at our request.

Mr. REID of Illinois. Yes; the gentleman ought to organize his conferees and know what he wants.

Mr. MADDEN. Now, I do not want to take up the time of the gentleman from Tennessee, but if we are going to consider the amendment which I have offered, and which has been pending, and which was pending before my colleague offered his amendment, we ought to do it before the gentleman's amendment comes along, because then it may be said that I have slept on my rights in offering this amendment here and that I no longer have any right to offer the amendment.

I want to move to strike out section 3, but I do not want to offer to strike out that part of the section, if the amendment is adopted, that the gentleman has just introduced but which has not been acted upon.

Mr. REID of Illinois. The gentleman can include it in his substitute.

The CHAIRMAN. The gentleman from Illinois can offer his amendment in that form.

Mr. MADDEN. Mr. Chairman, I would like to have my amendment read for information now, if I may.

The CHAIRMAN. Without objection, the Clerk will report for the information of the committee the amendment of the gentleman from Illinois.

The Clerk read as follows:

Amendment proposed by Mr. MADDEN: Strike out section 3 and substitute the following:

"SEC. 3. Except when authorized by the Secretary of War, upon the recommendation of the Chief of Engineers, no money appropriated under authority of this act shall be expended on the construction of any item of the project until the States or local interests to be benefited and protected have indicated their desire for Federal assistance by giving assurances satisfactory to the Secretary of War that they will, (a) maintain all flood-control works after their completion, except controlling and regulating spillway structures, including special relief levees; (b) provide without cost to the United States such drainage work as may be necessary and the rights of way for the levees and other structures as and when the same are required. Work on the so-called Bonnet Carre spillway will be undertaken when the city of New Orleans, in recognition of its paramount interest therein, shall have undertaken to hold and save the United States from all damage claims arising out of the construction of the spillway. Work on the so-called New Madrid flood way will be undertaken when interests in southern Illinois and southeastern Missouri, in recognition of their paramount interest therein, shall jointly or severally have entered into a similar undertaking."

Mr. MADDEN. The question is whether this would come before the other amendments that are pending or before the amendment of the gentleman from Tennessee.

The CHAIRMAN. Perfecting amendments are to be disposed of before the amendment involving the striking out of the section is voted on. The question is on the amendment offered by the gentleman from Illinois, the chairman of the committee.

Mr. GARRETT of Tennessee. Mr. Chairman——

The CHAIRMAN. Does the gentleman from Tennessee desire recognition on his amendment?

Mr. GARRETT of Tennessee. I do, Mr. Chairman.

The CHAIRMAN. The gentleman from Tennessee is recognized.

Mr. GARRETT of Tennessee. Mr. Chairman, the situation which exists in Tennessee, I think, has come to be very, very well known to the membership of the House. Bear in mind that the Congress is officially adopting the Jadwin plan so far as the engineering part of that plan is concerned, plus a further consideration of the Mississippi River Commission's plan, with a view to combining the best parts of the two. Neither of these plans in any way promises anything to any part of Tennessee except injury. The only way I can see to meet the situation is in the way I am proposing here and in the language that is offered.

I appreciate, of course, the tremendousness of this problem, but I am sure every Member of the House who understands the situation realizes that we of Tennessee are not here as mendicants in this matter; we are simply here asking to be protected in our rights, and asking that our equities may be respected and worked out.

I very much hope, Mr. Chairman, the amendment may prevail.

Mr. COX. Mr. Chairman, I ask recognition on this amendment.

Mr. Chairman, if I understand the amendment offered by the gentleman from Tennessee, it is simply to take care of a limited territory here and there which is subjected to overflow as a result of the execution of this project; that is, subjecting lands to overflow as a result of the execution of these plans, which have not heretofore been overflowed by the flood waters of the river.

I have in mind, gentlemen—and I beg your attention to this statement—areas along the main river which will be damaged, in all probability, as a result of the execution of the plans, unless some work or works be constructed for the purpose of holding off flood waters. These are certain lands in the State of Tennessee which are limited in area, and lands in Kentucky, particularly the town of Hickman, which will be overflowed and damaged as a direct consequence of the proposed improvement. These areas and others similarly situated along the river should be protected.

Let me say, my colleagues, this amendment is not proposed for the purpose of obligating the Government to make good all damages that may result because of the execution of this project. The statement has been made by Members opposing the bill that they are not opposed to the Government paying or compensating for any land that is taken or that is damaged as a result of the execution of the project, which land would be immune from damage if the work proposed was not done. My friend, the gentleman from New York [Mr. LAGUARDIA], made the statement this morning, in effect, that he was willing that the Government be committed to the proposition of paying the damage that the Government might cause, and this amendment is to put the Government in the position where this can be done, so far as property along the main river is concerned.

Mr. LAGUARDIA. Will the gentleman yield?

Mr. COX. I will.

Mr. LAGUARDIA. Will the gentleman's amendment take care of the actual damage sustained or the prospective damages that might be sustained?

Mr. COX. No; the actual damage. The effect of the amendment is this, that where, in the execution of the Jadwin plan for flood control an area is endangered as the result of the work which it is impracticable to protect by any sort of flood-protective works the Government shall acquire either the absolute title to the land or flooded rights therein.

Mr. WHITTINGTON. Will the gentleman yield?

Mr. COX. Certainly.

Mr. WHITTINGTON. I would like to ask the gentleman from Georgia about what area the Government would have to acquire for flood rights?

Mr. COX. I am not in a position to state to the gentleman what the area in Tennessee might be.

Mr. WHITTINGTON. And elsewhere?

Mr. COX. This would not apply to any territory except that on the main stem of the stream.

Mr. GARRETT of Tennessee. It would apply to Tennessee and the Mississippi situation.

Mr. COX. Yes; and elsewhere along the Mississippi River proper.

Mr. REID of Illinois. Mr. Chairman, I ask unanimous consent that all debate on the pending amendment and section close in 15 minutes.

The CHAIRMAN. The gentleman from Illinois asks unanimous consent that all debate on the section and amendments close in 15 minutes.

Mr. O'CONNOR of Louisiana. I suggest to the gentleman that he make it 30 minutes.

Mr. REID of Illinois. I will make it 20 minutes.

Mr. LAGUARDIA. Will the gentleman make it apply to the pending amendment only? I have an amendment that I would like to get five minutes on, although I have a suspicion of what is going to happen.

Mr. O'CONNOR of Louisiana. Reserving the right to object, I want to ask the chairman of the committee if that would give any time to my colleague Mr. SPEARING and myself?

Mr. REID of Illinois. I do not know.

Mr. O'CONNOR of Louisiana. Then I object. Members who do not live in this flooded locality can get an hour or an hour and a half, but Members who live in the territory affected, in the valley of the Mississippi River, can not get five minutes; it is ridiculous.

Mr. REID of Illinois. Mr. Chairman, I move that all debate on this section and all amendments thereto close in 30 minutes.

Mr. DENISON. A parliamentary inquiry, Mr. Chairman. Does that apply to amendments that are not yet offered?

The CHAIRMAN. It applies to the section and all amendments.

Mr. WINGO. Mr. Chairman, I offer an amendment to the amendment of the gentleman from Illinois, that all debate on this section and amendments thereto close in 10 minutes.

Mr. SPEARING. And I offer an amendment to the amendment striking out 10 minutes and making it 1 hour.

The CHAIRMAN. That amendment is an amendment to an amendment to an amendment, and therefore not in order. The question is on the amendment offered by the gentleman from Arkansas to the amendment offered by the gentleman from Illinois [Mr. REID.]

The question was taken; and on a division, there were 35 ayes and 87 noes.

So the amendment to the amendment was rejected.

The CHAIRMAN. The question now is on the amendment of the gentleman from Illinois to close debate on the section and all amendments thereto in 30 minutes.

The question was taken, and the amendment was rejected.

Mr. MADDEN. Mr. Chairman, I rise to discuss the amendment I have offered.

The CHAIRMAN. The amendment pending should be disposed of before further amendments are offered. The question is on the amendment offered by the gentleman from Tennessee [Mr. GARRETT] to the amendment offered by the gentleman from Illinois, chairman of the committee.

The question was taken; and on a division (demanded by Mr. GARRETT of Tennessee) there were 111 ayes and 79 noes.

So the amendment of Mr. GARRETT of Tennessee to the amendment was agreed to.

The CHAIRMAN. The question recurs on the amendment of the gentleman from Illinois as amended by the amendment of the gentleman from Tennessee.

The question was taken, and the amendment as amended was agreed to.

The CHAIRMAN. The gentleman from Illinois [Mr. MADDEN] offers an amendment, which the Clerk will again report.

The Clerk read as follows:

Amendment by Mr. MADDEN: Strike out section 3 and substitute the following:

"SEC. 3. Except when authorized by the Secretary of War upon the recommendation of the Chief of Engineers, no money appropriated under the authority of this act shall be expended on the construction of any item of the project until the States or local interests to be benefited and protected have indicated their desire for Federal assistance by giving assurances satisfactory to the Secretary of War that they will (a) maintain all flood-control works after their completion, except controlling and regulating spillway structures, including special relief levees, (b) provide without cost to the United States such drainage works as may be necessary, and the rights of way for all levees and other structures as and when the structures are required. Work on the so-called Bonnet Carre spillway will be undertaken when the city of New Orleans, in recognition of its paramount interest therein, shall have undertaken to hold and save the United States from damage claims arising out of the construction of the spillway. Work on the so-called New Madrid flood way will be undertaken when interests in southern Illinois and southeast Missouri, in recognition of their para-

No. 18,275

IN THE

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For the Ninth Circuit

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Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the Judgment of the United States District Court for the Northern District of California, Northern Division

Honorable Sherrill Halbert, Judge

APPELLANTS' REPLY BRIEF

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Subject Index

Table of Authorities Cited

Cases

Statutes

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APPELLANTS' REPLY BRIEF

I

INTRODUCTION

This is a case of the collapse of levees caused by the Government forcing waters into the artificially leveed channel which waters nature would not have drained to the place where defective artificial levees burst. By this series of events the lands of the claimants became covered with water and their property damaged or destroyed.

Appellants respectfully urge that they should have been permitted to prove that this flooding of their lands was not a natural flood but a man-made flood.

The government contends that it is not liable, by virtue of Section 702c, for a government-made flood.

II

ANALYSIS OF "BRIEF FOR THE APPELLEE"

A. PRELIMINARY

The United States of America has filed a twenty-six page "Brief for the Appellee" with only seven pages of "Argument" in response to our seventy-five page "Appellants' Opening Brief." While we would quickly concede that the respective number of pages alone should not be significant, we do submit that nature of the case at bar warrants more than a cursory handling by the government of the United States unless, as appears from the "Brief for the Appellee", the Government is left with no real argument of substance for its position and there is no real basis in law to support the rulings of the Trial Court.

We shall therefore reply to each point set forth in the Government's "Brief for the Appellee" and then point out the numerous points of substance urged in "Appellants' Opening Brief" but utterly ignored in the Government's "Brief for the Appellee."

B. COMMENTS ON POINTS URGED IN BRIEF FOR APPELLEE

1. Table of Authorities

A glance at the "Table of Authorities" in the respective briefs reveals fifty-two cases cited in Appellants' Opening Brief and only four cases cited in the Government's "Brief for Appellee," two of which are strong cases against the position of the Government. Thus in this litigation the Government relies *wholly* on two cases—*Clark v. U.S.* (C.C.A. 9th, 1954) 218 F. 2d 446, and *National Manufacturing Co. v. U.S.* (C.C.A. 8th, 1954), 210 F. 2d 263, the force of which we will discuss fully later in this Reply Brief.

2. Statement of the Case

A. As to the Facts. (Brief for the Appellee, pp. 2-8.)

Under this heading the Government does not challenge Appellants' "Statement of the Case" (A.O.B. 2-7) but merely refers to "certain other pertinent facts which show the magnitude of the rainfall and streamflow in the Feather River basin during the critical month of December, 1955". (Brief for Appellee, p. 2.)

The Government here shows that there was a big storm. This we do not dispute. But was the magnitude of this rainfall and streamflow reasonably forseeable? The government does not contend it was not. The Trial Court refused to permit Appellants to prove that the amount of rainfall and the amount of streamflow was reasonably forseeable by the United States

Corps of Engineers, by the United States Weather Bureau, or by a reasonably prudent person under the same or similar circumstances. (A.O.B. p. 24 and R.T. 684:20-685:1.)

What the Government, and the Trial Court, say is that the Government can build a limited capacity flood control project which the Government knows will not contain waters reasonably to be expected to flow into the project, and when the inevitable happens, Section 702c immunizes them from the inevitable result of the conduct of the Government.

THIS WAS NOT AN "ACT OF GOD" FLOOD, AND NEITHER THE TRIAL COURT NOR THE GOVERNMENT SO CONTEND. THIS STORM WAS REASONABLY FORESEEABLE.

B. As to Procedure. (Brief for Appellee, pp. 6-8.)

Nothing in this section of the "Brief for Appellee" in any manner contributes to a reasonable decision on this Appeal.

C. As to Contentions. (Brief for Appellee, pp. 6-8.)

Here the Government has clearly set forth the respective contentions of the parties. Appellants contend that this was a man-made flood. The Government contends that it is not liable, under 702c, for a man-made flood.

The Government contends it is not liable under the Federal Tort Claims Act for a flood it negligently creates!

3. Specification of Errors. (Brief for Appellee, pp. 9-18.)

A. The Government asserts that Appellants are mistaken in stating that the Trial Court held Section 702c to be an immunity statute.

The Trial Court, in its "Memorandum and Order" dated April 23, 1962 (Cl. Tr. 75; A.O.B. 11):

> "It appears that Section 702c was, and is, *intended to save* the United States harmless *from liability* in cases involving natural floods, or flood waters, whether or not there is a concurrence of negligence with such flood waters."

"Intended to save harmless." "Immunity." Is there a difference? Is this not a rose by another name?

B. The Government urges, *solely* on the basis of the case of *National Manufacturing Co. v. U.S.* (1954) 210 F. 2d 263, that the Trial Court was correct in holding that proximate cause was not an issue in the case at bar.

C. The Government concedes that the Trial Court refused to permit Appellants to introduce any evidence on the issue of whether the flood here in question was a "man-made" or a "government-made" flood, and urges that the Trial Court correctly refused such evidence even though the Trial Court in its "Memorandum and Order" of April 23, 1962, specifically ruled that Section 702c would not render the Government "harmless" from "inundations of an artificial nature, solely caused by the instrumentalities of man." (Cl. Tr. 75.)

Appellants offered to prove, but the offers of proof were rejected by the Trial Court, that the claimants in these cases were damaged by a flood either solely caused by the negligence of the government or concurrently with acts of nature caused by the negligence of the government. (See A.O.B. pp. 18-24.)

When the Government collects rainfall and run-off into a container and transports that water twenty-five and forty miles from the natural drainage of that water, is it a proper use of the legal term "proximate cause" to say, when the container burst twenty-five miles and forty miles from the water's natural drainage, that *nature* caused the container to break? Or that the flooding of land from such activity was not *caused solely* by the acts of man in transporting water out of natural drainage in a limited container which became overloaded and burst solely because man tried to put more water in the container than it would hold? Would such a flood be a natural flood or a man-made flood?

The Trial Court said that even if you prove this, 702c renders the Government immune.

4. Argument. (Brief for the Appellee, pp. 18-25.)

The government's "Argument" consists of saying Appellants are wrong in contending that the only two cases the government relies on do not warrant a judgment in favor of the government, that the legislative history of Section 702c was "fully presented" to the Court in *Court v. U.S., supra* and in *National Mfg.*

Co. v. U.S., supra, when the fact is that the government presented its excerpts of the legislative history but not one word of legislative history was presented in these two cases by plaintiffs' counsel, that the *Atkinson* case (126 F.S. 406) is wrong because it recognizes the distinction between natural and man-made floods, and the *Aycrigg* case (No. 6299, N.D. Calif.) should be construed to support the government's position here because a private bill was necessary in a case which arose out of the 1937 floods (before the enactment of the Federal Tort Claims Act in 1946). All the Government really says is that the *Aycrigg* case required a private bill at a time when the only method by which one could sue the government for negligence was by means of a private bill. The legal effect of Sec. 702c was exactly the same in relation to the private bill in the *Aycrigg* case as in relation to the Federal Tort Claims Act in the cases at bar.

The Government's "Argument" ends with two interesting comments on page 24 of the "Brief for the Appellee." It says, after referring to the *Clark* case and *National Mfg.* case:

> "The decision here on appeal was based on these decisions, is equally correct . . ."

The Freudian equivocation—"equally correct"! May we respectfully query—equally incorrect?

The Government's argument ends with the limp argument that the *Clark* and *National Manufacturing* cases

> ". . . should not now be seriously questioned."

This argument for the perpetuation of erroneous concepts of law is the last gasp of a dying doctrine. When all else fails, when reasonable legal principles utterly destroy an erroneous authority, we then hear this argument.

Our plea to this Court is to reconsider the *Clark* case. We do seriously question the language of that case, and of the *National Manufacturing* case. We trust that the United States Court of Appeals is willing to listen to serious questions concerning cases which are urged to support the contention of the Government, as set forth in its "Conclusion" (Brief for the Appellee, p. 25) that by Section 702 the Congress of the United States *intended* innocent victims of the negligence of the Government to bear the full financial burden of the Government's misconduct.

III

POINTS RAISED IN APPELLANTS' OPENING BRIEF BUT IGNORED IN BRIEF FOR THE APPELLEE

A. MAN-MADE FLOOD

Appellants' Opening Brief repeatedly pointed out that Appellants not only urged, but offered to prove that the water on Appellants' lands was "from or by" a man-made flood. (A.O.B. pp. 6, 16, 17, 18-25.)

The Trial Court refused to permit Appellants to introduce evidence to prove that this was a man-made flood.

Appellants' Opening Brief, pages 66-67, points out that even one of the two cases relied on by the Government, the *National Manufacturing* case, acknowledges inferentially Appellants' position here when it said that there would be no liability on the United States where there is damage from or by a flood or flood waters "in spite of and notwithstanding federal flood control works," thereby inferring liability where there is flood damage from or by a flood or flood waters *because of* federal flood control works. The Government ignored this point.

Appellants' Opening Brief, pages 5 and 16-25, points out that there was a natural spillway at Hamilton Bend which allowed waters in excess of the leveed channel at Gum Tree and Nicolaus to drain off west into Butte Basin and thus not enter the leveed channel, that four times in the last 50 years but for this safety valve at Hamilton Bend, the levees at Gum Tree and Nicolaus would have been overloaded, and that this natural spillway or safety-valve at Hamilton Bend was closed in 1955 by the federal government, thus making the levee breaks inevitable. The Government ignored this point.

Appellants urged that the structure and location of the levee system was essential to a determination of whether this flood was a natural flood or a man-made flood, but the Trial Court refused to permit Appellants to prove where these levees were located! (A.O.B. 24.) The Trial Court thus prevented Appellants from proving that, from the plans, designs, construction, and location of these levees, this flood was

not a natural flood, but a man-made flood. The Government ignored this point.

We respectfully submit that Section 702c was not intended to immunize the government from liability from a man-made flood as distinct from a natural flood. It is no answer to merely say this was natural water as all water is natural. The Government transported natural water twenty-five to forty miles out of its natural drainage and the container broke at two weak spots. Does the fact that the container was a levee system rather than a convoy of trucks change the basic fact that water was not where nature would have put it, and that the *cause* of the damage was man's transportation and man's defective container? If a tank on a truck transporting the same water to the same locations out of natural drainage had sprung a leak and the water thus escaping had damaged property, would any Court say Section 702c immunized the Government from tort liability under the Federal Tort Claims Act?

We suggest that the reason the Government ignores these points is that it recognizes and cannot get any Government attorney to say, that Section 702c immunizes the Government from liability "from or by" man-made floods.

Appellants respectfully ask the right to prove that the damage to their property was "from or by" man-made floods.

B. CONCURRENT CAUSATION

Appellants' Opening Brief at pages 67-69 specifically pointed out that normal rules of concurrent causation apply and that an Act of God does not excuse negligent conduct of man. The Trial Court twisted this basic rule of liability by saying that, despite the normal rule that Act of God must be the *sole* cause of damage before it constitutes a defense, in this case he would hold a new and novel (and frightening!) rule to exist that man is liable only if his conduct is the *sole* cause of damage, and that man (the Government) is exempt if God is his co-tortfeasor.

The Government ignores this point.

C. CONGRESSIONAL HISTORY

Appellants' Opening Brief, page 37, specifically points out that a careful examination of the Congressional History of the Flood Control Act of 1928, including Section 702c, reveals that the term "negligence" was never used and the concept of negligence or tort was never alluded to. The Government ignores this point.

Appellants' Opening Brief, pages 37-39, specifically points out that flood control was referred to in the Congressional debates while considering the Federal Tort Claims Act, and that the only reasonable inference from this Congressional History is that negligent flood control is actionable. The Government ignores this point.

Appellants' Opening Brief, page 66, specifically points out that Section 702c does not say that the United States is not liable for damages "due to the construction works", although that phrase is contained in the hold-harmless clause in both Section 701c and 702 A-12, and that under accepted rules of statutory construction, different phrases in the same chapter of the United States Code should be construed to have different meanings. The Government ignores this point.

D. CASE HISTORY

Appellants' Opening Brief, page 40, specifically cites eight cases which have mentioned Section 702c and specifically requested the United States Attorney to state whether he knows any additional cases which refer to Section 702c. The Government ignores this point.

Appellants' Opening Brief, pages 55-65, cites and discusses eight cases in which the Courts of the United States of America have recognized the liability of the United States for flood damage. The Government ignores this point except as to the *Atkinson* and *Aycrigg* cases.

Appellants' Opening Brief, pages 60-63, cites and discusses the case of *Coates v. U.S.* (1951) 181 F. 2d 816 which quotes from Congressional Committee reports and from Law Review articles in its discussion of non-negligent flood control activities of the federal government from which the only reasonable inference

is that the Court of Appeals, Eighth Circuit recognized that negligent flood control by the federal Government would give rise to a cause of action under the Federal Tort Claims Act. The Government ignores this case and ignores the point.

E. BECAUSE OF, NOT IN SPITE OF, FEDERAL FLOOD CONTROL WORKS

Appellants' Opening Brief, pages 66-67, pointed out that both the cases of *U.S. v. Sponenbarger* (1939) 84 L. Ed. 239 and *National Manufacturing Co. v. U.S.* (1954) 210 F. 2d 263 recognize liability on the part of the Federal Government for flood damage *because of* federal flood control works. The Government ignored the *Sponenbarger* case and ignored this point.

F. CONSTITUTIONALITY OF SECTION 702c

Appellants' Opening Brief, pages 69-74, fully discussed, with numerous citations, the point that the interpretation of Section 702c urged by the Trial Court would render the statute unconstitutional.

The Government did not challenge or answer Appellants' authorities—it ignored them.

While the Government has chosen to ignore the fifty-two cases cited by Appellants in support of their arguments, we will not ignore, but will reply to all the cases cited by the Government as supporting its argument—all two of them.

IV

NATIONAL MANUFACTURING COMPANY v. U. S. (1954) 210 F. 2d 263

One of the two cases relied on by the Government in support of its immunity theory is the *National Manufacturing Co.* case.

Property of many plaintiffs was damaged or destroyed by flood waters of the Kansas River in 1951. The Federal Government had constructed flood control works along the Kansas River and through variout governmental agencies disseminated information and predictions relating to flooding. The flood waters of the Kansas River rose, overflowed the levees, and flooded sections of Kansas City and adjacent lowlands where plaintiffs' properties were damaged.

There was no contention, as in the cases at bar, that conduct of the Government in fact *caused* the flood.

There was no contention as in the cases at bar, that the Government negligently planned, designed, constructed, maintained, or operated the flood control works.

There was no contention, as in the cases at bar, that the Government by the exercise of ordinary care could have prevented the waters from flooding plaintiffs' lands.

There was no contention, as in the cases at bar, that the levees were defective and collapsed because of negligent construction.

There was no contention, as in the cases at bar, of bad levees.

There was no contention, as in the cases at bar, that the damages occurred *because of,* and not in spite of the flood control works.

There was no contention, as in the cases at bar, of the Government diverting water out of natural drainage to the place of the damage.

There was no contention, as in the cases at bar, that the flood was a man-made flood.

What was, and what was not contended is clearly stated by the Court in its opinion (210 F. 2d at 269) in these words:

> "It was not charged in either of the complaints here that the United States was liable to any of the plaintiffs because the Kansas River overflowed the banks, levees and works within which it was normally confined, but the allegations of the complaint in each of the consolidated cases were limited to the effect that the United States became liable because the Weather Bureau and other federal agencies (1) negligently assured the plaintiffs immediately prior to the flood that the river would not overflow and (2) negligently omitted and failed to give the plaintiffs notice and warning of the impending overflow in time for them to remove their movable property from the flood area. In the *Shipley* case the plaintiff has relied on the second claim.
>
> The gravamen of the plaintiffs' cases was that the Federal Tort Claims Act should be so interpreted as to impose responsibility upon the United States for flood damage to plaintiffs' movable property in these cases because, as alleged, the United

States was negligent in making or withholding Kansas river stage and flood forecasts."

The Court held that the Government is not liable under the Federal Tort Claims Act for the negligence charged, which was solely negligent assurances of safety and negligent dissemination of flood forecasts. The cases at bar do no include similar contentions. There was nothing in the record of the *National Manufacturing* case to indicate that the flood there was anything but a natural flood and not a man-made flood. The frequent references to "Act of God" disasters in the opinion of the Court appear justified because no one contended to the contrary. Thus we feel the decision in the *National Manufacturing* case is consistent with our view of the meaning of Section 702c that there is no liability for damages occurring solely as a result of a natural flood.

However, the *National Manufacturing* case goes much farther than necessary and, to the delight of the Government, uses language which it finds comforting in saying that Section 702c bars recovery even where negligence of the Government is a proximate cause of damage "from or by floods or flood waters." (210 F. 2d at page 271.)

Considerable reference is made in the *National Manufacturing* case to portions of Congressional History submitted by the Government, and left unchallenged. In the cases at bar we have submitted considerable Congressional History showing that the contentions, and the conclusions in the *National Manufacturing* case were incorrect in two respects.

(1) The contention that there was a Congressional Policy of non-liability for indemnification of flood victims where the damage occurred *because* of negligent flood control is not correct. The language urged by the Government has been applied *only* in cases of natural floods, and has not been applied where negligent engineering on flood control works proximately caused the flooding of plaintiff's lands. This is what occurred in the *Aycrigg* case, when negligent construction of a levee near Marysville caused a collapse of the levee in the 1937 floods, and Congress authorized the litigation against the federal government for a case in which the damage occurred nine years before the Federal Tort Claims Act became law. The waters in the *Aycrigg* case were of the same character as the waters in the cases at bar as they were from the same leveed channel about five miles above the Gum Tree break. Liability followed in the *Aycrigg* case because the damage to plaintiffs' property was from a man-made flood.

(2) The Congressional History of Section 702c does not refer to the terms "negligence" or "tort liability" and despite our flat assertion on page 37 of Appellant's Opening Brief, the government has not been able to quote a single word from the Congressional Record which in any way tempers our assertion. There is nothing in the Congressional Record to justify the contention of the Government that 702c was meant to bar liability for negligent construction of flood control levees.

We submit that the language in the *National Manufacturing* case which the Government deems most helpful to its case is no longer the law of this land as it reflects the now rejected concepts of the case of *Dalehite v. US* (1952) 346 US 15 to the effect that the Federal Tort Claims Act "did not change the normal rule that an alleged failure or carelessness of public firemen does not create private actionable rights", a concept squarely rejected in the cases of *Indian Towing v. US* (1955) 350 US 61, and *Rayonier v. US* (1957) 352 US 215 wherein the Supreme Court said:

> ". . . the very purpose of the Tort Claims Act was to waive the Government's traditional all-encompassing immunity from tort actions and to establish novel and unprecedented governmental liability."

The language in the *National Manufacturing* case at page 275 rejecting the concept of damages caused by *negligent* flood control must be deemed no longer the law as it specifically held that the Federal Tort Claims Act was not enacted to "visit the government with novel and unprecedented liabilities."

Thus, the basic rationale of the *National Manufacturing* case upon which the Government, and to a lesser extent the Trial Court here, relied, is simply not the law.

Is it not significant that the Government in its "Brief for the Appellee" utterly ignored this point even though in our Opening Brief, pages 41, 42 and 43 we had so fully pointed this out?

We further submit that the language in the *National Manufacturing* case should not be construed to mean

that that Court was of the opinion that there was immunity from damages caused by negligent construction of flood control works as this same Court, in fact two of the same three Justices (Sanborn and Woodrough), participated in the case of *Coates v. US* (1951) 181 F. 2d 816 in which the Court recognized the liability of the United States for damages resulting from negligent construction or maintenance of a flood control project.

We respectfully submit that the *National Manufacturing* case cannot be deemed persuasive authority because it did not involve the construction of bad levees, and reflected the now rejected thinking of the *Dalehite* case.

V

CLARK v. U. S. (1954) 218 F. 2d 446

The only other case upon which the Government, and the Trial Court, rely in support of their position in the cases at bar is the case of *Clark v. US, supra.*

We recognize that this case was decided by the Court to which we now appeal.

In the *Clark* case the Trial Court took evidence on the factual issue of negligence and made a specific finding of no negligence on the part of anyone. The Trial Court in the case at bar refused to take evidence on the factual issue of negligence.

Can we say that either the Trial Court or the Court of Appeals in the *Clark* case would have ruled the same had there been a finding of negligence by the Corps of Engineers in the construction or maintenance of the embankment which failed? We submit that a

careful reading of the opinion of this Court would support the interpretation that this point was not specifically covered. The question of negligence in construction and maintenance of the embankment was disposed of by this Court on the basis that the Trial Court found no negligence, and that the railroads were not federal agencies within the purview of the Federal Tort Claims Act even though "seized" by the Government during a labor dispute. This Court, in the *Clark* case *did not say* that the Government would not be liable for damage resulting, or proximately caused, by negligent design or construction of a levee.

All the reference to "non-liability" of the United States was with reference to the charge of negligent flood fighting by the Corps of Engineers and not to construction or maintenance. There was a specific finding by the Trial Court that the Corps of Engineers was not negligent. The language of this Court on page 452 of 218 F. 2d, in the *Clark* case to the effect that

> "The provision of 33 USCA Section 702c barring liability 'from or by floods or flood waters' expresses a policy that any federal aid to the local authorities in charge of flood control shall be conditioned upon federal non-liability."

we respectfully submit is not warranted by the Congressional History, the case law on the subject of damages resulting from flooding, and by basic principles of the law of torts. If this language is confined in its application to the narrow point then under discussion in the *Clark* case—fighting a natural flood—little harm is done. The *Clark* case did not involve a man-made flood.

But, we respectfully submit, such language should not be applied to a case in which the proximate cause of the damage is negligent design and negligent construction of levees which if reasonably designed and constructed would not have failed.

All Appellants here are urging is that this Court declare that the Government is required, under our principles of law, to govern in the manner of a reasonable man, and that when the government conducts itself in the manner of an unreasonable man it should be held liable just as a private individual. This is the spirit of democracy, for to permit the government to govern in a manner less than reasonable is the very antithesis of our system of government.

Is that a frightening thought? Is that an unreasonable request?

VI

FLOODS OR FLOOD WATERS

The Government seems mesmerized by the phrase "flood or flood waters." Few words have but a single meaning. The Trial Court simply decided that there was a lot of water. We do not believe Congress meant merely "a lot of water", but rather water running wild. The water, before the break was not running wild, but was flowing in the leveed channel.

The Trial Court in the case at bar ruled that waters confined by the leveed channel were "flood waters." (204 FS at 483.)

Subsequent to the Trial Court opinion in the case at bar a well reasoned opinion was handed down in the case of *Beckley v. Reclamation Board* (1962) 205 CA 2d 734, in which the District Court of Appeal of the State of California came to the opposite conclusion, and ruled that waters confined by levees are not "flood waters" on the basis that flood waters retain their character as flood waters *only* while vagrant, i.e., "flowing wild" over the country.

We submit that the reasoning of the *Beckley* case, *supra*, is reasonable and persuasive and that waters between the levees should not be deemed "flood waters" as that phrase is used in Section 702c.

However, regardless of this point, we respectfully submit that the statute should not be construed to mean immunity in this case just because the statute used the words "flood or flood waters" where, as here, the cause of the water damaging plaintiffs' property was the collapse of a levee.

If a statute stated that "no liability shall attach to the United States for damage from or by wild animals" would such a statute be construed to create imunity or "non-liability" for injury by wild animals escaping from a Government zoo? We think not.

VII

KINCAID v. U. S.—THE "FUSE-PLUG" CASES

The "Brief for the Appellee' in the Appendix, page x, cites the case of *Kincaid v. U.S.* (1929) 35 F. 2d 235 as authority for the proposition that Section 702c was

intended "to put . . . beyond argument" the point that the Federal Government will not pay for flood damage.

A careful reading of this case, and the other reported decisions of the same case, we believe, lend much more support to the propositions we here urge than to the position of the Government.

The cases of *Kincaid v. U.S.* are reported as follows:

35 F. 2d 235 (1929);
37 F 2d 602 (1929);
49 F. 2d 768 (1931);
285 US 95 (1931).

These cases are known as the "fuse-plug" cases because they involved the rights of landowners in floodways on the Mississippi River which would become flooded from time to time in the event of high water on the Mississippi River. The levees of the Mississippi were protected from the problem in the cases at bar, as rather than forcing more water into the leveed channel than the levees would hold, the levees contained a section of lower levee made of less resistant soil so that when the water reached the design level, the main levee at that point would break and the excess waters would be diverted through training levees and thus relieve the pressure on the main leveed channel.

The Government claimed it had the right to flood the lands of those plaintiffs, and that the landowners so flooded had no cause of action for damages. After long litigation the Supreme Court, while holding that the landowners could not enjoin the construction of the flood control project, said:

> "We assume that, as charged, the mere adoption by Congress of a plan of flood control which involves an intentional, additional, occasional flooding of complainants' land constitutes a taking of it." (285 U.S. 95 at 103)

In the case at bar the Government built a project which it knew would have drained into it waters in excess of its capacity, but, in 1955, they closed the natural spillway, and left no "fuse-plug" designed to relieve the pressure. Thus, the weak spots on the levee became fuse-plugs and burst when water in excess of capacity drained into the project. This was inevitable. It was inherent in the project that this would happen. In a sense this was intentional, although the location of the fuse-plug was left to chance. The Government knew this would happen. The damage here was a direct result of the plan, design, and construction of the project.

The Trial Court discussed Section 702c in the *Kincaid* case (35 F 2d 235 at 245 and 246) and did *not* say this section created immunity but rather said, after asserting liability:

> "One cannot help but be impressed that the act as finally passed was an unskilled compromise, first, between those claiming that the state should bear a portion of the burden as against others insisting that the government pay the whole cost; and, secondly, those demanding that all injury suffered by property owners in the floodways should be compensated, while others contended that the government should not be made responsible for anything except property actually taken

and to be occupied by the levees and other work contemplated by the project."

"An unskilled compromise." So said the Court. This does not sound like a firm policy of Congress to assert non-liability for damage because of, not in spite of, the flood control project.

It could well be argued that the cases at bar are very similar to the fuse-plug levee cases in that it was inevitable that "additional destructive waters" would pass over plaintiffs' lands by reason of diversions from the main channel of the Feather through the weakest spots in the levees when the levees became overloaded *as the Government knew would happen.* The weakest spots in the levees were inadvertent fuse-plugs.

The breaking of the levees on the Feather were inherent in the plan and design of the project, as the Government knew water in excess of capacity would drain into the project, but the locations of the breaks were left to chance rather than to orderly plan as in the case of the fuse-plug levees.

The opinion in 37 F. 2d 602 contains these thoughtful words:

At page 605:

"Those within the floodway will live under a constant menace, for no one can tell in what years meteorological conditions will require the use of their lands for the purpose intended by the plan; i.e., a floodway."

And further at page 605:

"However, as pointed out in the former opinion in this case, there is no escape from the proposi-

> tion that the complainant's property, and that of all others similarly situated, will be, by express design of the plan, compelled to bear the whole burden whenever the necessity arises."

And at page 607:

> "But when the government departed from the policy of building levees and other public works for the purpose of commerce and navigation alone, and expressly entered the field of controlling floods for the protection and reclamation of private lands, then it became engaged in activities which make it responsible for the invasion of private rights. It will not be assumed that Congress intended to violate the Fifth Amendment to the Constitution by taking private property for public purposes without just compensation."

And at page 607:

> ". . . mere size and magnitude of the condition with which we are dealing cannot alter the principle."

VIII

CONCLUSION

Appellants respectfully submit that Section 702c does not bar a cause of action based upon proof of a man-made flood caused by the negligence of the Government in the plan, design, construction, maintenance or operation of a flood control project.

The Government is in the untenable position of relying on two cases (*National Manufacturing* and *Clark*) for a proposition that the Government is not

liable for a Government-made flood when neither of those cases involved Government-made floods, and the language relied upon by the Government in those cases has been rejected by the United States Supreme Court in the *Indian Towing* and *Rayonier* cases, both *supra.*

In neither the *National Manufacturing* case nor the *Clark* case did the conduct of the Government contribute to *causing* the water to flow upon those plaintiffs' lands.

In the case at bar the conduct of the Government was the sole proximate cause of water flowing onto plaintiff's lands.

Here, the flood was *caused by the Government.* Significantly the Government does not dispute this! The Government merely wants to prevent us from proving it.

Can the Government *cause* a flood and then claim "non-liability" because it is a flood?

Is this not somewhat like the small boy who killed his Mother and killed his Father and then pleaded for mercy because he was an orphan?

Dated, June 28, 1963.

Respectfully submitted,
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No. 18,275

IN THE

United States Court of Appeals

For the Ninth Circuit

RAYMOND L. STOVER, et al.,
Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the Judgment of the United States District Court
for the Northern District of California,
Northern Division
Honorable Sherrill Halbert, Judge

APPELLANTS' PETITION FOR A REHEARING

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Subject Index

Table of Authorities Cited

Statutes

Texts

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APPELLANTS' PETITION FOR A REHEARING

To the Honorable Chief Judge and to the Honorable Associate Judges of the United States Court of Appeals for the Ninth Circuit:

I

INTRODUCTION

Appellants respectfully petition for rehearing in the above-entitled consolidated cases.

This petition for rehearing is sought on the grounds of several erroneous statements and inferences in the printed Opinion of this Court. We will set forth each erroneous statement or erroneous inference separately together with a quotation, with specific transcript references, as to each correct statement or inference.

II

GROUND NUMBER ONE

The Opinion states on pages two and three:

"The trial court had a trial on the applicability of section 702c.

In a pre-trial order the court ruled that 33 U.S.C. section 702c 'applied to all floods and flood waters which result in whole or in part from unusual or extraordinary precipitation' and defined 'unusual or extraordinary' as meaning 'conditions which, in the light of experience, would not be anticipated by a normal person using ordinary care.' Then it went on to say section 702 'does not apply to "man-made floods" which result solely from negligent acts.' Then the term 'man-made flood' was defined as a 'flood which is created solely by the construction or fabrication of a barrier which, but for the barrier, would not have been impounded.'

In its findings of fact the court said: the waters were unusual and extraordinary. For amplification of the court's findings see the court's opinion. Stover v. United States, 204 F. Supp. 477. Evidence of negligent construction was excluded as not being within the issues of the trial on the applicability of 702c.

If the court adhered to its original definition, we believe it found that the rains and runoff were not foreseeable. If that be the case, would one even reach the applicability of section 702c? Under general negligence is there ever liability for the thing that cannot reasonably be foreseen by the ordinary prudent person who plans waterways?"

These paragraphs are in error in the following particulars:

1. While the *Pre-Trial Order* did define "unusual or extraordinary" precipitation as meaning "conditions which, in the light of experience, would not be anticipated by a normal person using ordinary care", the Trial Court specifically rejected Appellants' offers of proof that:

> "The amount of precipitation which contributed to the water which injured the plaintiffs was reasonably foreseeable by:
>
> (1) The United States Government, Corps of Engineers, and Weather Bureau, and
>
> (2) A reasonably prudent person under the same or similar circumstances"
>
> (R.T. 684:20-685:1; Appellants' Opening Brief, p. 24)

> "The amount of flow which contributed to each break was reasonably foreseeable by:
>
> (1) The United States Corps of Engineers and Weather Bureau, and
>
> (2) A reasonably prudent person under the same or similar circumstances."
>
> (R.T. 685:20-686:1; Appellants' Opening Brief, p. 24)

Therefore the sentence in the Opinion at the top of page 3:

> "If the court adhered to its original definition, we believe it found that the rains and runoff were not foreseeable."

contains an erroneous inference as the Trial Court specifically refused to hear evidence proving *beyond*

any doubt that the amount of precipitation and the amount of flow were both foreseeable.

2. While the Opinion states on page 2:

> "In its findings of fact the court said: the waters were unusual and extraordinary."

the fact is that the Trial Court *did not adhere* to its original definition of unusual and extraordinary, as it had rejected Appellants' offers of proof as above quoted, but rather, the Trial Court changed its definition in its "Conclusions of Law" saying:

> ". . . unusual or extraordinary climatic conditions, that is, from climatic conditions which are so severe that a reasonably prudent person using ordinary care would expect a flood to occur as a result of such conditions." (Cl. Tr. 36:23-27.)

Thus we see that the Trial Court not only *did not rule* that the rains and runoff were not foreseeable, but rather ruled that foreseeability was not an issue, and further ruled that "unusual or extraordinary" meant, climatic conditions which would be expected to produce a flood.

In plain language, the Trial Court did not define "flood or flood waters" in the manner stated or inferred in the Opinion of this Court.

The Trial Court defined a "man-made" flood, ruled that Section 702c does not apply to a man-made flood, and then rejected Appellants' offers of proof to prove that this was a man-made flood.

(Appellant's Opening Brief, pages 16-25.)

III

GROUND NUMBER TWO

The Opinion states on page 3:

> "and there really would not be any reason to legislate on damage caused purely by nature."

To the contrary there was reason, and frequently is reason to enact legislation which is nothing more than a codification of a common-law rule. The reason here was that Congress, in embarking on a broad program of flood control, did not want this legislation to be construed as an acceptance by the Government of liability for flood damage not caused by conduct of the Government.

Many statutes are merely examples of legislative recognition of generally accepted common law principles. In fact, if we accept the government's argument that governmental immunity is a common law principle and that this is an immunity statute, then Section 702c is merely a legislative recognition of that principle, and, in the language of this Court "there really would not be any reason to legislate."

That many statutes are merely declaratory of the common law is well stated in 50 Am. Jur. 339-342, Statutes, Sec. 346, in these words:

> "There are many cases in which particular statutes under consideration are regarded as declaratory of the common law."

The question here is not whether Section 702c was a mere legislative recognition of a then generally accepted principle of law, but *which "generally accepted*

principle'' was intended to be recognized by this statute.

The ground upon which we urge this point for rehearing is that there is not one word in the legislative history to support a conclusion that Section 702c was meant to be an immunity statute, but rather the legislative history rejects such a conclusion.

IV

GROUND NUMBER THREE

On page three of the Opinion the Opinion states:

> ''Appellants finally contend that if 33 USC 702c bars a suit for damage caused by negligent federal planning of a flood control project then the section is unconstitutional as causing a taking without just compensation proscribed by the Fifth Amendment.''

We respectfully refer the Court to Appellants' Opening Brief, pages 69-74 wherein we discussed the Constitutional question and point out that we did not mention or refer to the eminent domain question, nor did we refer to the eminent domain question in our oral argument.

Appellants' contention with respect to the constitutional question was that Section 702c, if construed as an immunity statute, would be unconstitutional as a *denial of due process of law* as it would destroy a right without providing a reasonable substitute.

Simply stated, the Opinion speaks of a constitutional question not raised by Appellants, and the Opinion fails to mention the constitutional question which was raised by Appellants.

V

CONCLUSION

Appellants' respectfully seek rehearing in these cases on the grounds that it contains major erroneous statements of fact and law.

The errors are:

1. The inference that the rains and run-off were not foreseeable, when the Trial Court had refused to permit Appellants to prove that they were foreseeable.

2. The statement that the Court's reference to "unusual and extraordinary" meant unforeseeable when the Trial Court specifically ruled that it meant climatic conditions which would be expected to produce a flood.

3. The inference that the statute should be construed as an immunity statute because Appellants' construction would merely be a codification of a recognized legal principle, when construing the statute as an immunity statute would itself merely be a codification of a then recognized legal principle.

4. The statement that Appellants urged that Section 702c be held unconstitutional because of the eminent domain provision of the Fifth Amendment